TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1937

No. 667

THE UNITED STATES, PETITIONER

vs.

HARRY A. KAPLAN

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

PETITION FOR CERTIORARI FILED JANUARY 4, 1938
CERTIORARI GRANTED FEBRUARY 14, 1938

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In the Court of Claims

No. 42901

HARRY A. KAPLAN, PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

I. *Petition*

Filed January 23, 1935

thé honorable the Chief Justice and the Judges of the Court of Claims:

I

he plaintiff, a citizen of the United States and a resident of the y of New York, County of New York, files this petition to re- er from the United States of America, $2,084.20 or such greater unt as may be legally due, being the amount due your plaintiff n the United States as and for income taxes erroneously and gally assessed and collected from the plaintiff by the Commis- er of Internal Revenue of the United States, together with in- st thereon at 6 per cent per annum from March 15, 1930, to the e of refund.

II

he Commissioner of Internal Revenue, at all times hereinafter tioned, was an officer of the United States duly qualified and ap- nted to act for and on behalf of the United States in all mat- hereinafter set forth.

pon information and belief, your plaintiff avers that the each and y sum hereinafter stated to have been paid by him, was paid to Collector of Internal Revenue for the Second District of New k at New York City, New York, and was thereafter turned over nd deposited with the Treasurer of the United States of America n the usual course of official business.

III

he plaintiff duly filed his Federal income tax return for the tax- e year 1929 on March 15, 1930, and paid the tax due thereon hin the time and in the manner provided by law.

IV

Included in the aforesaid return for the taxable year 1929 referred to in Paragraph III above, was an item of $194,000.00, which the plaintiff erroneously reported as profit from the sale during the year 1929 of 25 shares of stock in 1100 Park Avenue and upon which erroneous profit the plaintiff erroneously paid, on March 15, 1930, a tax of not less than $2,084.20 to the Collector of Internal Revenue for the Second District of New York.

3

V

During the year 1929 the plaintiff sold said 25 shares of stock in 1100 Park Avenue for $250,000.00 and paid a commission on said sale of $10,000.00, leaving a net selling price of $240,000.00. The 25 shares of stock cost the plaintiff $46,000.00. The plaintiff erroneously reported on his Federal income tax return the sum of $194,000.00 as profit on the sale taxable for the year 1929. Said reported profit on the sale was computed by plaintiff by subtracting $46,000.00 (cost price) from $240,000.00 (net selling price).

However, under the terms of the agreement of sale the plaintiff received $25,000.00 down on the date of the sale of the stock and the balance of the purchase price was payable by the vendee in monthly installments of $1,875.00 each over a period of ten years.

In all the plaintiff received from the sale during the year 1929 the sum of $30,625.00, which was less than 40 per cent of the amount of the purchase price of $250,000.00.

VI

The plaintiff erroneously and mistakenly reported a 1929 profit of $194,000.00 from the sale of the 25 shares of stock in 1100 Park Avenue in that he kept his books of account and filed his Federal income tax returns on the cash receipts and disbursements basis and the $194,000.00 reported as profit in 1929 from the sale did not correctly reflect the taxpayer's taxable income from the sale in 1929.

The plaintiff was lawfully entitled to report the profit from the sale of the stock on the installment basis in that the payments received from the sale during 1929 were less than 40 per cent
4 of the sale price and the balance of the sale price was to be paid in monthly installments over a period of ten years.

VII

The error in reporting the profit from the sale of the 25 shares of stock in 1100 Park Avenue for the year 1929 was called to the attention of the Internal Revenue Agent who audited plaintiff's return for the year 1929 and said Revenue Agent recommended a refund of $2,084.20 to the plaintiff for the year 1929 on the ground that only

$24,755.20 profit from the sale was taxable to plaintiff for the year 1929, computed as follows:

Total cash received 1929	$30, 625. 00
% Net selling price to Net profit	. 808333
% multiplied by cash received equals profit applicable to 1929	24, 755. 20
Profit reported 1929	194, 000. 00
Profit applicable to subsequent years	$169, 244. 80

The plaintiff thereupon and within two years from the date of payment of the tax of $2,084.20 on March 15, 1930, duly filed with the Collector of Internal Revenue for the Second District of New York a claim for the refund of said $2,084.20 with interest as required by law.

VIII

The Commissioner of Internal Revenue rejected the aforesaid claim for refund by registered mail on January 24, 1933.

5

IX

The Commissioner of Internal Revenue erroneously and unlawfully rejected the aforesaid claim for refund and erroneously and illegally assessed the tax of $2,084.20 for the year 1929 and the Collector of Internal Revenue for the Second District of New York erroneously and illegally collected said tax of $2,084.20 in that the plaintiff was rightfully and lawfully entitled to report the 1929 profit on the sale of the 25 shares of stock on the installment basis.

X

Your plaintiff is not afforded an appeal to any department of the Bureau of Internal Revenue nor to any other department of the Executive branch of the Government from the action of the Commissioner of Internal Revenue in rejecting his application for relief as hereinabove set forth. No action upon this claim, other than that herein stated, has been taken before Congress or other of the departments of the United States, or in any court other than the petition filed in this court.

XI

Your plaintiff has at all times borne true allegiance to the Government of the United States and has not in any way voluntarily aided, abetted, or given encouragement to rebellion against said Government. Your plaintiff is the sole and absolute owner of the claim herewith presented and has made no transfer or assignment of said claim or of any part thereof, and is justly entitled to the amount claimed herein from the United States after allowing all just credits and set-offs.

6 XII

Your plaintiff believes the facts as herein stated to be true.

Wherefore, your plaintiff prays judgment in his favor and against the United States of America for the sum of $2,084.20 for 1929 income taxes erroneously and illegally collected from him and for interest at six per cent per annum from March 15, 1930, to the date of refund and for such other and further relief as in the premises to this Court may seem meet and proper.

(Signed) LLEWELLYN A. LUCE,
937 Munsey Building, Washington, D. C.,
Attorney for Plaintiff.

[*Duly sworn to by Llewellyn A. Luce; jurat omitted in printing.*]

7 II. *General traverse*

Filed March 4, 1935

And now comes the Attorney General, on behalf of the United States, and answering the petition of the plaintiff herein, denies each and every allegation therein contained; and asks judgment that the petition be dismissed.

FRANK J. WIDEMAN,
Assistant Attorney General.

III. *Argument and submission of case*

On February 8, 1937, this case was argued and submitted by Mr. Llewellyn A. Luce, for plaintiff, and by Mr. George W. Billings, for defendant.

8 IV. *Special findings of fact, conclusion of law and opinion of the court by Littleton, J.*

Filed April 26, 1937

Mr. Llewellyn A. Luce for the plaintiff.

Mr. George W. Billings, with whom was Mr. Assistant Attorney General Robert H. Jackson, for the defendant.

Mr. Robert N. Anderson and Mr. Fred K. Dyar, Special Assistants to the Attorney General, were on the brief.

Plaintiff seeks to recover $2,084.20, income tax alleged to have been overpaid for 1929, on the ground that the profit from the sale of twenty-five shares of stock in that year should have been computed on the installment basis under section 44 of the Revenue Act of 1928 and Treasury Department regulations. A claim for refund was duly filed and rejected.

Special findings of fact

A joint income-tax return of plaintiff, Harry A. Kaplan, and his , Ethel, for the year 1929 was filed March 15, 1930, indicating a tax of $2,084.20 which was paid—$584.20 on March 17, 1930, the balance of $1,500 in the amount of $500 each on June 13 October 16, 1930, and $500 on July 23, 1931. For 1929 and all equent years plaintiff kept his books of account and made his eral-tax returns on the cash receipts and disbursements basis. cluded in gross income in the return was an amount of $194,000, g the difference between a net selling price of $240,000 and a purchase price of $46,000 paid in June 1928 for shares of stock in "1100 Park Avenue" which Harry A. Kaplan, April 11, 1929, agreed to sell under a contract whereby the purchaser to pay $250,000 as follows: $25,000 down and $225,000 in monthly illments of $1,875 beginning October 1, 1929, together with rest, the shares in the meantime to be deposited in escrow. The ntiff in 1929 paid $10,000 commission on the transaction, making net selling price to him $240,000. On December 28, 1929, plain- agreed to an assignment made September 23, 1929, by the pur- er of his obligations under the contract to a third party, the as Holding Corporation.

uring 1929 plaintiff received from the purchaser or his assignee 525 on the sales contract; in 1930 he received $22,500 in monthly allments of $1,875; and in the first three months of 1931, $5,601.51, r which time the agreed payments ceased. By agreement of ust 12, 1931, between Ethel Kaplan, to whom plaintiff had as- ed his interest in the contract for a nominal consideration, and Comas Holding Corporation, the balance of $191,273.49 was to aid $2,273.49 down and $2,000 monthly beginning September 1, . In 1931 there was paid to plaintiff on the revised agreement 73.49 to the end of October, at which time payments again ceased. urther agreement was entered into March 19, 1932, between Ethel lan and the Samuel Silver Realty Co., Inc., whereby the former eed to sell the same shares of stock to the latter for $75,000, pay- $750 down and the balance in monthly installments of $750 nning April 10, 1932.

Plaintiff filed a joint income-tax return for himself and wife 1930 on March 16, 1931, showing no taxable income and no sale tock in "1100 Park Avenue" or profit or loss thereon. Plaintiff no income-tax returns either for 1931 or 1932.

Internal Revenue Agent in Charge, R. T. Miles, New York City, fied plaintiff by letter November 18, 1931, of his decision, after it and investigation of the 1929 return, to recommend an over- ssment of $2,084.20 for 1919, conceding plaintiff's right to com- pute the tax on the sale here involved on the installment basis.

February 29, 1932, the Commissioner of Internal Revenue notified plaintiff of his disapproval of the internal revenue nt's report and stated that no overassessment was disclosed.

4. March 12, 1932, plaintiff filed a claim for the refund of $2,084.20 for 1920 on the ground that he was lawfully entitled to report the stocks-sale transaction on the installment basis. The Commissioner of Internal Revenue rejected this claim January 23, 1933.

Conclusion of law

Upon the foregoing special findings of fact, which are made a part of the judgment herein, the court decides, as a conclusion of law, that plaintiff is entitled to recover $2,084.20 with interest as provided by law.

It is therefore adjudged and ordered that the plaintiff recover of and from the United States two thousand eighty-four dollars and twenty cents ($2,084.20) with interest at the rate of 6% per annum on $584.20 thereof from March 7, 1930, and on $500 from June 13, 1930, on $500 from October 16, 1930, and on $500 from July 23, 1931, to such date as the Commissioner of Internal Revenue may determine in accordance with the provision of section 177 (b) of the Judicial Code, being a part of the Revenue Act of 1928.

Opinion

LITTLETON, Judge, delivered the opinion of the court:

The provisions of section 44 (a), (b), and (c) of the Revenue Act of 1928 and the applicable portions of Art. 351 of Treas-
11 ury Regulations 74 are set forth in the margin.[1] Subdivision (b) (1) of section 44 governs this case. This was a casual sale in 1929 of personal property for a price in excess of $1,000 and the initial payment was less than 40% of the selling price. Plaintiff, therefore, was entitled to report this transaction on the installment basis and to return as income therefrom in 1929 that proportion of the installment payments actually received in that year which the

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[1] Sec. 44. (a) Dealers in Personal Property. Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price.

(b) Sales of Realty and Casual Sales of Personalty. In the case (1) of a casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year), for a price exceeding $1,000, or (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed 30 per centum of the selling price (or, in case the sale or other disposition was in a taxable year beginning prior to January 1, 1934, the percentage of the selling price prescribed in the law applicable to such year), the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this section. As used in this section the term "initial payments" means the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made.

(c) Change from Accrual to Installment Basis. If a taxpayer entitled to the benefits of subsection (a) elects for any taxable year to report his net income on the installment basis, then in computing his income for the year of change or any subsequent year, amounts actually received during any such year on account of sales or other dispositions of property made in any prior year shall not be excluded.

Regs. 74, Art. 351: "* * * In the case of a casual sale or other casual disposition of personal property other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, for a price exceeding $1,000, income may be returned on the installment basis provided the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale or other disposition is made do not exceed 40 per cent of the selling price. * * *."

gross profit realized or to be realized, when payment was completed, bore to the total contract price.

The only defense made by counsel for the defendant is that plaintiff, having made an election to report in his return for 1929 the sale of this stock as a completed transaction reflecting a profit of $194,000, is unalterably bound by that election and cannot have his tax for 1929 determined on the basis of an installment sale so far as that transaction is concerned. We think there is no merit in this contention. Section 44 contains no language which may be construed as imposing upon a taxpayer, in a case such as the one at bar,
12 a binding and irrevocable election when such taxpayer erroneously and mistakenly reports in his return for the taxable year the entire profit which it appears at the time may be ultimately received from the transaction, when, as a matter of fact and law, the transaction is an installment sale within the meaning of the federal taxing act and the regulations upon which the taxpayer is entitled to report as income therefrom in the taxable year that proportion of the installment payments actually received in such year which the gross profit realized or to be realized, when payment is completed, bears to the total contract price. Davis v. United States, 71 C. Cls. 444, 46 Fed. (2d) 377. S. J. Schneider, Trustee of Estate of Bagby-Howe Drug Co., Bankrupt, v. Lucas (15 A. F. T. R. 572), reversed on other grounds in Lucas v. Schneider, 47 Fed. (2d) 1006. See also G. C. M. 2367, VI-2 C. B. 172; G. C. M. 13466, XIII-2 C. B. 144.

Counsel for defendant seem to base their claims for a b[in]ding election upon the words "may return as income", found in subdivision (a) of section 44 of the Revenue Act of 1928, but these installment-sales provisions of the statute were dealing with all classes of installment sales, and we think it is clear that Congress did not intend that a taxpayer employing the cash receipts and disbursements basis of accounting who might report in the year of a sale an entire anticipated profit not actually received could not, if the amount of the initial payments received in such taxable year did not exceed 40% of the sales price, have his tax for such year later computed on the installment-sales basis. The Treasury Regulations did not so interpret the statute. The statute merely states that the income from an installment sale may be reported in the manner prescribed. It is clear that the words "may return" were used to permit the large number of taxpayers engaged in the installment-sales business to use either the accrual method or the installment-sales method of reporting income, and even where the former is used the statute permits a change to the installment method. The regulations do not so much as imply that a choice of computing profit on one or the other method in reporting a
13 casual sale of property shall be construed as a binding election.

The statute gives the Commissioner no discretionary power to reject a timely claim for refund or to refuse to compute a tax-

payer's income in a case like the one at bar where the taxpayer on the cash receipts and disbursements basis receives in the taxable year less than 40% of the sales price under an installment-sales contract. Moreover, the basis on which plaintiff reported the transaction in his return for 1929 and the basis on which the Bureau held him taxable when the claim for refund was finally rejected in 1933 did not clearly reflect plaintiff's income. In March 1932, almost a year before the Commissioner rejected plaintiff's refund claim, the contract of sale of the stock in question was changed and the then unpaid purchase price thereof was reduced to $75,000. The maximum amount which plaintiff therefore could ever receive under the contract for sale of the stock was $139,999 instead of a net selling price of $240,000, which is $54,000 in excess of the sum stated as profit in the return for 1929.

Counsel for defendant endeavors to make the point that if plaintiff is permitted to recover in this case the Government may lose some tax on the installment payments received in 1930 and that plaintiff will also escape tax on the installment payments received in 1931 and 1932. The years 1931 and 1932 may be disregarded for the reason that plaintiff filed no returns for those years and any tax that might be due may still be collected. Any tax that may be barred for 1930 on the installment payments received in that year is barred because of the decision made by the Bureau of Internal Revenue at a time when any tax which might have been due by plaintiff for the year 1930 was not barred. The Internal Revenue Agent in Charge at New York filed with the Commissioner a report in November 1931 showing a computation of plaintiff's tax for 1929 on the installment basis and disclosing an overpayment of $2,084.20. The Bureau rejected this computation, refused to compute plaintiff's tax for 1929 on the installment basis, and notified the plaintiff of that fact by letter of February 29, 1932. This view was adhered to until the final rejection of the claim for refund January 23, 1933.

14 Plaintiff is entitled to recover and judgment will be entered in favor of plaintiff for $2,084.20, with interest as provided by law. It is so ordered.

WHALEY, Judge; WILLIAMS, Judge; GREEN, Judge; and BOOTH, Chief Justice, concur.

15 V. *Judgment*

At a Court of Claims held at the City of Washington on the 26th day of April A. D., 1937, judgment was ordered to be entered as follows:

Upon the special findings of fact, which are made a part of the judgment herein, the court decides, as a conclusion of law, that plaintiff is entitled to recover.

It is therefore adjudged and ordered that the plaintiff recover of and from the United States two thousand eighty-four dollars and

nty cents ($2,084.20) with interest at the rate of 6% per annum $584.20 thereof from March 7, 1930, and on $500 from June 13, 0, on $500 from October 16, 1930, and on $500 from July 23, 1931, such date as the Commissioner of Internal Revenue may deterne in accordance with the provision of section 177 ~~(b)~~ of the licial Code, being a part of the Revenue Act of 1928.

VII. *Proceedings after entry of judgment*

On June 24, 1937, the defendant filed a motion for a new trial.
On October 4, 1937, the court entered the following order on said tion:

ORDER

It is ordered this 4th day of October 1937, that the defendant's motion for new trial be and the same is overruled.

[Clerk's certificate to foregoing transcript omitted in printing.]

[Endorsement on cover:] File No. 42148. Court of Claims. Term . 667. The United States, petitioner, vs. Harry A. Kaplan. Petin for a writ of certiorari and exhibit thereto. Filed January 4, 38. Term No. 667 O. T. 1937.

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Supreme Court of the United States

Order allowing certiorari

Filed February 14, 1938

The petition herein for a writ of certiorari to the Court of Claims is granted, and the case is assigned for argument immediately following No. 528.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Mr. Justice REED took no part in the consideration or decision of this application.

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In the Supreme Court of the United States

OCTOBER TERM, 1937

No. —

UNITED STATES OF AMERICA, PETITIONER

v.

HARRY A. KAPLAN

PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS

The Solicitor General, on behalf of the United States, prays that a writ of certiorari issue to review the judgment of the Court of Claims in favor of the plaintiff below for the sum of $2,084.20, with interest, entered under date of April 26, 1937.

OPINION BELOW

The special findings of fact, conclusions of law, and opinon of the Court of Claims are reported in 18 F. Supp. 965.

JURISDICTION

The judgment of the Court of Claims was entered April 26, 1937. A motion for a new trial was filed by the United States on June 24,

1937, and was denied by the Court on October 4, 1937. The jurisdiction of this Court is invoked under Section 3 (b) of the Act of February 13, 1925.

QUESTION PRESENTED

The only question presented is whether the taxpayer, who sold certain securities at a profit during his taxable year 1929 and reported the entire profit therefrom in his 1929 income tax return in accordance with his method of keeping his books, can later recover the tax paid for 1929 by treating the sale as an installment sale taxable in accordance with the provisions of Section 44 (b) of the Revenue Act of 1928.

STATUTE AND REGULATIONS INVOLVED

The pertinent statute and regulations involved in this case are printed in the Appendix, *infra*, pp. 9–14.

STATEMENT

The Court of Claims made the following special findings of fact:

> 1. A joint income-tax return of plaintiff, Harry A. Kaplan, and his wife, Ethel, for the year 1929 was filed March 15, 1930, indicating a total tax of $2,084.20 which was paid—$584.20 on March 17, 1930, and the balance of $1,500 in the amount of $500 each on June 13 and October 16, 1930, and $500 on July 23, 1931. For 1929 and all subsequent years plaintiff kept his books of ac-

count and made his Federal-tax returns on the cash receipts and disbursements basis.

Included in gross income in the return was an amount of $194,000, being the difference between a net selling price of $240,000 and a purchase price of $46,000 paid in June 1928 for shares of stock in "1100 Park Avenue" which Harry A. Kaplan, April 11, 1929, agreed to sell under a contract whereby the purchaser was to pay $250,000, as follows: $25,000 down and $225,000 in monthly installments of $1,875 beginning October 1, 1929, together with interest, the shares in the meantime to be deposited in escrow. The plaintiff in 1929 paid $10,000 commission on the transaction, making the net selling price to him $240,000. On December 28, 1929, plaintiff agreed to an assignment made September 23, 1929, by the purchaser of his obligations under the contract to a third party, the Comas Holding Corporation.

During 1929 plaintiff received from the purchaser or his assignee $30,625 on the sales contract; in 1930 he received $22,500 in monthly installments of $1,875; and in the first three months of 1931, $5,601.51, after which time the agreed payments ceased. By agreement of August 12, 1931, between Ethel Kaplan, to whom plaintiff had assigned his interest in the contract for a nominal consideration, and the Comas Holding Corporation, the balance of $191,273.49 was to be paid $2,273.49 down and $2,000 monthly beginning September 1, 1931. In 1931 there was paid to plaintiff on the

revised agreement $6,273.49 to the end of October, at which time payments again ceased. A further agreement was entered into March 19, 1932, between Ethel Kaplan and the Samuel Silver Realty Co., Inc., whereby the former agreed to sell the same shares of stock to the latter for $75,000, payable $750 down and the balance in monthly installments of $750 beginning April 10, 1932.

2. Plaintiff filed a joint income-tax return for himself and wife for 1930 on March 16, 1930, showing no taxable income and no sale of stock in "1100 Park Avenue" or profit or loss thereon. Plaintiff filed no income-tax returns either for 1931 or 1932.

3. Internal Revenue Agent in Charge, R. T. Miles, New York City, notified plaintiff by letter November 18, 1931, of his decision, after audit and investigation of the 1929 return, to recommend an overassessment of $2,084.20 for 1919,[1] conceding plaintiff's right to compute the tax on the sale here involved on the installment basis.

February 29, 1932, the Commissioner of Internal Revenue notified plaintiff of his disapproval of the internal revenue agent's report and stated that no overassessment was disclosed.

4. March 12, 1932, plaintiff filed a claim for the refund of $2,084.20 for 1920[2] on the

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[1] The record shows this date to be 1919, but it should be 1929.

[2] The record shows this date to be 1920, but it should be 1929.

> ground that he was lawfully entitled to report the stocks-sale transaction on the installment basis. The Commissioner of Internal Revenue rejected this claim January 23, 1933.

On the basis of the foregoing special findings of fact the court concluded as a matter of law that the taxpayer was entitled to recover the amount of income tax originally paid for the year 1929, and entered judgment accordingly.

SPECIFICATION OF ERRORS TO BE URGED

The court below erred:

1. In holding that Section 44 (b) of the Revenue Act of 1928 governs in determining the amount taxable to the taxpayer for the year involved as profit derived from the sale of certain securities.

2. In holding that the taxpayer erroneously and mistakenly reported in his income tax return for the year of sale the full amount of profit derived from the sale of certain securities.

3. In holding that the method or basis adopted by the taxpayer for reporting his taxable income for the year involved did not clearly reflect his income.

4. In holding that the taxpayer's action in reporting in his income tax return for the year of sale the full amount of profit derived from the sale of certain securities did not constitute a binding election to have his profit taxed on that basis and did not preclude him from later having his

profit taxed under the provisions of Section 44 (b) of the Revenue Act of 1928.

5. In its conclusion of law, based upon its special findings of fact, that the taxpayer is entitled to recover the sum of $2,084.20, with interest, as provided by law.

6. In rendering judgment for the taxpayer for the sum of $2,084.20, with interest, and in failing to enter judgment for the United States dismissing the taxpayer's petition.

REASONS FOR GRANTING THE WRIT

In holding that the taxpayer is entitled to recover from the United States under the facts of this case the court below decided questions of law in such manner that its decision is in conflict with the decision of the Circuit Court of Appeals for the Ninth Circuit in *Pacific Nat. Co.* v. *Welch*, 91 F. (2d) 590. In that case it was found that the taxpayer purchased certain real property in 1927 which was thereupon transferred to a trustee, the taxpayer becoming the sole beneficiary. During 1927 the property was subdivided for sale, and lots were subsequently sold under circumstances which would have permitted the taxpayer to report its gains on the installment basis in accordance with the provisions of Section 44 of the Revenue Act of 1928. Instead, however, the taxpayer treated the sales as deferred payment sales (the obligations of purchasers being treated as having a fair market value equivalent to their face value) and reported

its gains from sales of lots in accordance with its method of keeping its accounts.

The Circuit Court of Appeals for the Ninth Circuit held that the method of accounting used by the Pacific National Company clearly reflected its income, that the company had properly reported its income in accordance with its method of accounting, and that having reported the profit from sales on the basis elected in making its return, the taxpayer was precluded from later claiming a refund for the year involved by having the profit from sales computed on the installment basis in accordance with the provisions of Section 44 of the Revenue Act of 1928.

The Pacific National Company filed a petition for certiorari, No. 528, present Term, which was granted on December 6, 1937. It based its petition upon an asserted conflict with the decision of the Court of Claims in the instant case and the decision of the Circuit Court of Appeals for the Fifth Circuit in *Morrow, Becker & Ewing, Inc.* v. *Commission*, 57 F. (2d) 1. In the brief in opposition filed in that case on behalf of the Collector of Internal Revenue the distinction between the *Pacific Nat. Co.* case and *Morrow, Becker & Ewing* v. *Commissioner, supra,* was pointed out at page 12. It was also suggested that while we believe the decision below in the instant case to be erroneous, the case could probably be distinguished in the light of the opinion of the Court of Claims in *Le Bolt & Co.* v. *United States,* 67 C. Cls. 422.

This Court granted a writ of certiorari in *Pacific Nat. Co.* v. *Welch*, *supra*, on December 6, 1937, presumably in the belief that there is a probable conflict between the decision of the Circuit Court of Appeals for the Ninth Circuit and the decision of the court below in the instant case. Since the facts found and the questions of law involved in the two cases are so similar, a writ of certiorari should also be granted to review the decision of the Court of Claims in the instant case.

Respectfully submitted.

STANLEY REED,
Solicitor General.

JANUARY 1938.

APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791:

PART II—COMPUTATION OF NET INCOME

SEC. 21. NET INCOME.

"Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

SEC. 22. GROSS INCOME.

(a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

* * * * *

(e) *Determination of gain or loss.*—In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in sections 111, 112, and 113.

PART IV—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but

if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year. (For use of inventories, see section 22 (c).)

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period.

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits provided for in this title shall be taken for the taxable year in which "paid or accrued" or "paid or incurred", dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period.

SEC. 44. INSTALLMENT BASIS.

(a) *Dealers in personal property.*—Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in

that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price.

(b) *Sales of realty and casual sales of personalty.*—In the case (1) of a casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year), for a price exceeding $1,000, or (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed 40 per centum of the selling price, the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this section. As used in this section the term "initial payments" means the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made.

(c) *Change from accrual to installment basis.*—If a taxpayer entitled to the benefits of subsection (a) elects for any taxable year to report his net income on the installment basis, then in computing his income for the year of change or any subsequent year, amounts actually received during any such year on account of sales or other dispositions of property made in any prior year shall not be excluded.

SUPPLEMENT B—COMPUTATION OF NET INCOME

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

(a) *Computation of gain or loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of

property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.

* * * * *

(c) *Amount realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(d) *Recognition of gain or loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 112.

(e) *Installment sales.*—Nothing in this section shall be construed to prevent (in the case of property sold under contract providing for payment in installments) the taxation of that portion of any installment payment representing gain or profit in the year in which such payment is received.

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * *

Treasury Regulations 74:

ART. 321. *Computation of net income.*—Net income must be computed with respect

to a fixed period. Usually that period is 12 months and is known as the taxable year. Items of income and of expenditures which as gross income and deductions are elements in the computation of net income need not be in the form of cash. It is sufficient that such items, if otherwise properly included in the computation, can be valued in terms of money. The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. (See articles 331–333.) If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation shall be made in such manner as in the opinion of the Commissioner clearly reflects it.

ART. 322. *Bases of computation.*—Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income. A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency. * * *

ART. 331. *When included in gross income.*—Gains, profits, and income are to be included in the gross income for the taxable year in which they are received by the taxpayer, unless they are included as of a different period in accordance with the ap-

proved method of accounting followed by him. * * *

ART. 351. *Sale of personal property on installment plan.*—

* * * * *

In the case of a casual sale or other casual disposition of personal property other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, for a price exceeding $1,000, income may be returned on the installment basis provided the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale or other disposition is made do not exceed 40 per cent of the selling price.

If for any reason the purchaser defaults in any of his payments, and the vendor returning income on the installment basis repossesses the property, the entire amount received in installment payments and retained by the vendor, less the sum of the profits previously returned as income and an amount representing proper allowance for damage and use, if any, will be income of the vendor for the year in which the property is repossessed, and the property repossessed must be carried on the books of the vendor at its original cost, less proper allowance for damage and use, if any.

If the vendor chooses as a matter of consistent practice to return the income from installment sales on the straight accrual or cash receipts and disbursements basis, such a course is permissible.

If an installment obligation is satisfied, or otherwise disposed of, gain or loss may result therefrom and must be determined in accordance with section 44 (d) and article 355.

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In the Supreme Court of the United States

OCTOBER TERM, 1937

No. 667

UNITED STATES OF AMERICA, PETITIONER

v.

HARRY A. KAPLAN

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

OPINION BELOW

The special findings of fact, conclusions of law, and opinion of the Court of Claims (R. 4–8) are reported at 18 F. Supp. 965.

JURISDICTION

The judgment of the Court of Claims was entered April 26, 1937. (R. 8–9.) A motion for a new trial was filed by the United States on June 24, 1937, and was denied by the Court on October 4, 1937. (R. 9.) The petition for certiorari was filed on January 4, 1938, and was granted February 14,

1938. The jurisdiction of this Court is conferred by Section 3 (b) of the Act of February 13, 1925.

QUESTION PRESENTED

The only question presented is whether the taxpayer, who sold certain securities at a profit during his taxable year 1929 and reported the entire profit therefrom in his 1929 income tax return in accordance with the method employed in keeping his books of account, can later recover the tax paid for 1929 by filing a refund claim treating the sale as an installment sale taxable on the installment basis in accordance with the provisions of Section 44 (b) of the Revenue Act of 1928.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations involved in this case are printed in the Appendix, *infra,* pp. 26–35.

STATEMENT

The pertinent facts contained in the special findings of fact by the Court of Claims (R. 5–6) are as follows:

On March 15, 1930, a joint income tax return of the respondent Harry A. Kaplan and of his wife was filed for the year 1929, indicating a total tax of $2,084.20 which was paid in instalments in 1930 and 1931. For 1929 and all subsequent years the respondent kept his books of account and made his returns on the cash receipts and disbursements basis.

There was included in the gross income reported in the 1929 return an amount of $194,000 which was the difference between a net selling price of $240,000 and a purchase price of $46,000 paid in June, 1928, for shares of stock in "1100 Park Avenue" which the respondent on April 11, 1929, agreed to sell under a contract whereby the purchaser was to pay $25,000 down and $225,000 in monthly instalments of $1,875, beginning October 1, 1929, together with interest, the shares in the meantime to be deposited in escrow. A commission of $10,000 on the transaction paid in 1929 by the respondent made the net selling price $240,000. On December 28, 1929, the respondent agreed to an assignment made September 23, 1929, by the purchaser of his obligations under the contract to the Comas Holding Corporation.

The respondent received from the purchaser or his assignee on the sales contract the sums of $30,625 in 1929, $22,500 in monthly instalments of $1,875 in 1930, and $5,601.51 in the first three months of 1931, and then the agreed payments ceased.

By agreement of August 12, 1931, between the respondent's wife, to whom he had assigned his interest in the contract for a nominal consideration, and the Comas Holding Corporation, the balance of $191,273.49 was to be paid $2,273.49 down and $2,000 monthly, beginning September 1, 1931. In 1931, $6,273.49 was paid to respondent on the re-

vised agreement to the end of October, and then the payments again ceased.

A further agreement was entered into on March 19, 1932, between the respondent's wife and the Samuel Silver Realty Company, Inc., whereby the former agreed to sell the same shares of stock to the latter for $75,000, payable $750 down and the remainder in monthly instalments of $750, beginning April 10, 1932.

The respondent filed a joint income tax return for himself and his wife for 1930 on March 16, 1931, showing no taxable income and no sale of stock in "1100 Park Avenue" or profit or loss thereon. No income tax return was filed by the respondent for either 1931 or 1932.

By a letter dated November 18, 1931, the Internal Revenue Agent in Charge at New York City notified the respondent of his decision, after audit and investigation of the 1929 return, to recommend an overassessment of $2,084.20 for 1929 [1], conceding the respondent's right to compute the tax in the sale here involved on the instalment basis. On February 29, 1932, the Commissioner of Internal Revenue notified the respondent of his disapproval of the Internal Revenue agent's report and stated that no overassessment was disclosed.

On March 12, 1932, the respondent filed a claim for the refund of the entire sum of $2,084.20 paid

[1] The transcript of record erroneously states this date to be 1919.

as income tax for 1929,[2] on the ground that he was lawfully entitled to the sale of stock on the installment basis. The refund claim was rejected on January 23, 1933. On January 23, 1935, the petition in this action was filed. (R. 1.)

Upon the special findings of fact, the court below made a conclusion of law that the respondent was entitled to recover with interest the tax paid for 1929 and entered judgment accordingly. (R. 8–9.)

On February 14, 1938, the petition for writ of certiorari was granted by this Court, and this case was set down for argument immediately after *Pacific National Company* v. *Welch*, 91 F. (2d) 590 (C. C. A. 9th), now pending before this Court, No. 528, present term, on writ of certiorari granted December 6, 1937.

SPECIFICATION OF ERRORS TO BE URGED

The court below erred:

1. In holding that Section 44 (b) of the Revenue Act of 1928 governs in determining the amount taxable to the taxpayer for the year involved as profit derived from the sale of certain securities.

2. In holding that the taxpayer erroneously and mistakenly reported in his income tax return for the year of sale the full amount of profit derived from the sale of certain securities.

3. In holding that the method or basis adopted by the taxpayer for reporting his taxable income

[2] The transcript of record erroneously states this date to be 1920.

for the year involved did not clearly reflect his income.

4. In holding that the taxpayer's action in reporting in his income tax return for the year of sale the full amount of profit derived from the sale of certain securities did not constitute a binding election to have his profit taxed on that basis and did not preclude him from later having his profit taxed under the provisions of Section 44 (b) of the Revenue Act of 1928.

5. In its conclusion of law, based upon its special findings of fact, that the taxpayer is entitled to recover the sum of $2,084.20, with interest, as provided by law.

6. In rendering judgment for the taxpayer for the sum of $2,084.20, with interest, and in failing to enter judgment for the United States dismissing the taxpayer's petition.

SUMMARY OF ARGUMENT

The respondent had the privilege, available at his election, of reporting the profit realized from the deferred payment sale of the stock either as a closed transaction in the year of the sale or on the installment basis in the years in which the deferred payments were received. In his return he elected to use the former of the two alternative methods. The method used clearly reflected his income.

The statute contemplates an election. The election is binding and prevents the taxpayer from changing to the instalment basis in a refund claim

in order to have a lesser income for the year of sale of the stock and a refund determined. The application of the principle of election is necessary for an orderly administration of the tax laws. To permit taxpayers to change would involve the serious administrative burden requiring the readjustment of the taxpayer's income for not only the year of sale but also all subsequent years in which deferred payments are made.

ARGUMENT

A TAXPAYER WHO REPORTS THE ENTIRE GAIN FROM A SALE OF PROPERTY AS GROSS INCOME FOR THE YEAR OF SALE CAN NOT LATER, BY CLAIMING A REFUND, HAVE TAXABLE PROFIT THEREFROM FOR THE YEAR OF SALE COMPUTED ON THE INSTALLMENT BASIS UNDER SECTION 44 (b) OF THE REVENUE ACT OF 1928

The "initial payments" within the meaning of Section 44 (b) of the Revenue Act of 1928 received in 1929 under the first contract for the sale of the stock dated April 11, 1929, were $30,625, a sum less than 40 per cent of the net selling price of $240,000. The taxpayer might have returned the profit on the instalment basis, but he elected in the joint return for 1929 filed on March 15, 1930, to return the entire profit of $194,000, the difference between the net selling price of $240,000 and the cost of $46,000, as gross income for 1929 under the method of reporting deferred payment sales, not on the instalment basis, recognized by the statute and Treasury Regulations (Revenue Act of 1928, Section 111 (c), Treasury Regulation 74, Articles 351–355).

A. THE STATUTE PERMITS ALTERNATIVE METHODS, AVAILABLE AT THE ELECTION OF THE TAXPAYER, OF REPORTING GAIN UPON CERTAIN DEFERRED PAYMENT SALES OF PROPERTY

Section 41 of the 1928 Act provides in part that the net income of a taxpayer shall be computed "in accordance with the method of accounting regularly employed in keeping the books of such taxpayer".[3]

"Method of accounting" as used here refers to the general bookkeeping system employed by a taxpayer and does not mean the treatment of individual items of receipt or expenditure. *United States* v. *American Can Co.,* 280 U. S. 412, 419; *Niles Bement Pond Co.* v. *United States,* 281 U. S. 357, 360; *Aluminum Castings Co.* v. *Routzahn,* 282 U. S. 92, 99.

A taxpayer may employ any "method of accounting" appropriate to his needs which clearly reflects income. The "method of accounting"

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[3] Prior to the enactment of the Revenue Act of 1916 returns were required to be made upon the basis of actual receipts and disbursements. It was found in the administration of the earlier laws, however, that the income could be more clearly reflected in many cases by the employment of an accrual method. Since 1916 the law has required returns to be made in accordance with the method of accounting employed by the taxpayer in keeping his books unless the method does not clearly reflect the income. *United States* v. *Anderson*, 269 U. S. 422, 438; *Aluminum Castings Co.* v. *Routzahn*, 282 U. S. 92, 96; Section 38 of the Corporation Excise Tax Act of August 5, 1909, c. 6, 36 Stat. 11; Section II, subdivision G (b) of the Income Tax Act of October 3, 1913, c. 16, 38 Stat. 114, 172; Sec. 13 (d) of the Revenue Act of 1916, c. 463, 39 Stat. 756; Sec. 212 (b) of the Revenue Acts of 1918, 1921, 1924, 1926; Sec. 41 of the Revenue Acts of 1928, 1932, 1934, and 1936.

ordinarily is the cash receipts and disbursements method employed by this respondent, or an accrual method.

No default of payments under the contract occurred until after March of 1931, two years after the sale was made and a year after the return was filed (R. 5). The respondent did not seek to change to the instalment basis until after a default on the contract.

The respondent contended that he erroneously and mistakenly reported a 1929 profit of $194,000 on the sale of the stock in that he kept his books of account and filed his returns on the cash receipts and disbursements basis and the $194,000 did not correctly reflect his taxable income from the sale of 1929 (R. 2). The court below stated in its opinion that Congress did not intend that a taxpayer on the cash basis reporting his entire profit not actually received could not have the tax later computed on the installment basis (R. 7). The court below also stated in its opinion that the basis on which the respondent reported the transaction in his 1929 return did not clearly reflect his income (R. 8).

The petitioner contends that the taxpayer elected to report all of the profit from the deferred payment sale of the stock in the year of the sale rather than on the installment basis; that the filing of his income tax return constituted the taxpayer's binding election and prevents a recomputation of the tax for the year of the sale on the installment basis;

and that to permit such a recomputation generally would impose an unjustified burden on the administration of the revenues.

The question discussed here is discussed also in the Government's brief in *Pacific National Company* v. *Welch,* No. 528, present Term, to be argued immediately before this case.

In cases involving the question whether the method of accounting reflects income, "It is not the province of the court to weigh and determine the relative merits of systems of accounting". *Brown* v. *Helvering,* 291 U. S. 193, 204–205. If it is found that the "method of accounting" employed by the taxpayer clearly reflects the income, the requirement that returns be made in accordance with such method is binding upon the taxpayer [4] and the Commissioner [5] alike. Correction of certain items of income does not amount to a rejection of such method. *United States* v. *American Can Co., supra,* p. 419.

Section 42 of the 1928 Act provides that the amount of all items of gross income "shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period".

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[4] *United States* v. *Anderson*, 269 U. S. 422; *United States* v. *Mitchell*, 271 U. S. 9; *Brown* v. *Helvering*, 291 U. S. 193.

[5] *American National Co.* v. *United States*, 274 U. S. 99.

Section 111 (a) provides that the gain from the sale of property shall be the excess of the "amount realized" over the basis provided in Section 113. Section 111 (c) provides that the amount realized shall be the sum of any money received plus the fair market value of the property (other than money) received. Treasury Regulations 74, Articles 354 and 561, provide for the exceptional case in which the property or obligations of the purchaser of property have no fair market value. Cf. *Burnet* v. *Logan*, 283 U. S. 404.

These provisions of the statute and regulations provide a complete and accurate method for determination of the gain or loss on the sale of property. Congress also provided an alternative method of reporting income on the installment basis in some cases. Section 111 (e) provides that nothing in Section 111 shall prevent the use of the installment method in reporting income from installment sales.

Section 44 (a) of the 1928 Act provides that a person who regularly sells or otherwise disposes of personal property on the installment plan *may*, under regulations prescribed by the Commissioner with the approval of the Secretary, "return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price". Subsection (b) of that section provides that in the case of a casual sale or

other disposition of personal property for a price exceeding $1,000, if the initial payments do not exceed 40 per centum of the selling price, "the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this section".

Section 44 of the Act obviously provides an alternative method, available at the election of the taxpayer, of reporting the profit derived from certain sales of property.

No provision corresponding to Section 44 of the 1928 Act was included in any of the revenue acts prior to the Revenue Act of 1926. For several years prior to 1926, however, the Commissioner of Internal Revenue had included provisions of the same general import in his regulations.[6] These provisions were likewise optional in their terms. Certain decisions of the Board of Tax Appeals[7] promulgated in 1925 cast considerable doubt upon the validity of these regulations, with the result that Congress included Section 212 (d) in the Revenue Act of 1926, which was made retroactive by Section 1208 of the Act to taxes imposed under prior

[6] See Article 117 of Treasury Regulations 33 (Revised) prescribed under the Revenue Act of 1917, and Articles 42, 44, and 45 of Treasury Regulations 45, 62, and 65, prescribed under the Revenue Acts of 1918, 1921, and 1924, respectively.

[7] *Manomet Cranberry Co.* v. *Commissioner*, 1 B. T. A. 706; *B. B. Todd, Inc.*, v. *Commissioner*, 1 B. T. A. 762; *Six Hundred and Fifty West End Ave. Co.* v. *Commissioner*, 2 B. T. A. 958.

acts.[8] This method of reporting profit upon the limited class of sales specified was not *required* by the Act as necessary to clearly reflect the income. It was *permitted*, at the option of the taxpayer, in order to alleviate hardship where application of either the cash receipts and disbursements method or an accrual method of accounting often required payment of the total tax in a single year upon the ascertained profit. *Burnet* v. *S. & L. Bldg. Corp.*, 288 U. S. 406, 413. That an election of the method of reporting profit from installment sales was contemplated by the statute is further emphasized by the fact that subsection (c) of Section 44 provides that if a taxpayer *elects* to report income on the installment basis, amounts received in the taxable year on sales made in prior years shall not be excluded.

B. THE REPORTING OF PROFIT FROM AN INSTALLMENT SALE OF PROPERTY ON EITHER METHOD PERMITTED BY THE STATUTE AND REGULATIONS CONSTITUTES A BINDING ELECTION

The respondent reported in his 1929 return the full amount of the difference between the cost of the property to him and the net sale price. Consistently, he did not report any part of the $22,500 received in monthly installment payments in 1930 in his return for 1930 (R. 5). It was in his refund claim filed on March 12, 1932, that the respondent

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[8] See S. Rep. No. 52, 69th Cong., 1st Sess., p. 19; H. Rep. No. 356, 69th Cong., 1st Sess., pp. 32–33; *Burnet* v. *S. & L. Bldg. Corp.*, 288 U. S. 406.

requested computation of his 1929 income on the installment basis (R. 6).

By reporting his entire gain from the sale of personal property as income for the year of sale the respondent elected to have his gain taxed on that basis rather than in accordance with Section 44 (b) of the Act, and that election is binding, both upon him and the Commissioner of Internal Revenue. *Commissioner* v. *Moore,* 48 F. (2d) 526 (C. C. A. 10th), certiorari denied, 284 U. S. 620, and *Commissioner* v. *Garber,* 50 F. (2d) 588 (C. C. A. 9th), involving the same transaction; *Roy* v. *Commissioner,* 69 F. (2d) 786 (C. C. A. 5th), certiorari denied, 293 U. S. 580; *Howbert* v. *Norris,* 72 F. (2d) 753 (C. C. A. 10th); *Livermore* v. *Miller* (C. C. A. 5th), decided January 26, 1938, not yet officially reported but published in 1938 Prentice-Hall Federal Tax Service, Vol. 1, paragraph 5.177; *Marks* v. *United States,* 18 F. Supp. 911 (S. D. N. Y.); *Strauss* v. *Commissioner,* 33 B. T. A. 855, affirmed, *per curiam,* 87 F. (2d) 1018 (C. C. A. 2d); *Viault* v. *Commissioner,* 36 B. T. A. 430; *Briarly* v. *Commissioner,* 29 B. T. A. 256; *Louis Werner Saw Mill Co.* v. *Commissioner,* 26 B. T. A. 141; *Liberty Realty Corp.* v. *Commissioner,* 26 B. T. A. 1119; *Morgan Rundel* v. *Commissioner,* 21 B. T. A. 1019; *Johnson Realty Trust* v. *Commissioner,* 21 B. T. A. 1333; *Gilbert W. Lee* v. *Commissioner,* 6 B. T. A. 135, affirmed, *per curiam,* 41 F. (2d) 1004 (C. C. A. 6th).

In *Gilbert W. Lee* v. *Commissioner, supra,* the taxpayer had made his returns upon the installment basis, and, in refusing to permit him to change to the cash receipts and disbursements basis, the Board said (p. 138):

> Having once made his election, the petitioner should not be allowed to change to a different basis merely because subsequent legislation or other events made it to his interest so to do. * * *

In *Morgan Rundel* v. *Commissioner, supra,* the Board stated (p. 1020):

> Subsequent events or a change of mind now make petitioner's choice of the installment basis not to his liking, and so he seeks another method which it is claimed will produce a lower tax.
>
> It has been held, however, in a number of cases that the filing of a return of income according to one of two alternative methods recognized by statute constitutes a binding election and the taxpayer may not thereafter report on another basis. * * *

The right to elect between two or more methods of making returns or of reporting income is recognized in other sections of the revenue acts. Section 51 of the Revenue Act of 1928 grants to married individuals the privilege of filing a single joint return, in lieu of separate returns, and the choice, by filing the return, constitutes a binding election. *Buttolph* v. *Commissioner,* 29 F. (2d) 695 (C. C. A. 7th); *Rose* v. *Grant,* 39 F. (2d) 340 (C. C. A. 5th);

Morris v. *Commissioner*, 40 F. (2d) 504 (C. C. A. 2d); *Anderson* v. *United States*, 48 F. (2d) 201 (C. C. A. 5th); *United States* v. *Pettigrew*, 81 F. (2d) 666 (C. C. A. 9th); *O'Rourke* v. *Commissioner*, 81 F. (2d) 668 (C. C. A. 9th). Cf. *McIntosh* v. *Wilkinson*, 36 F. (2d) 807 (E. D. Wis.).

Sections 141 and 142 of the 1928 Act grant to an affiliated group of corporations the privilege of filing a consolidated return in lieu of the separate returns required by Section 52 of the Act, and the exercise of that privilege, evidenced by making either kind of return, is binding when made. *Alameda Inv. Co.* v. *McLaughlin*, 33 F. (2d) 120 (C. C. A. 9th); *Lucas* v. *St. Louis National Baseball Club*, 42 F. (2d) 984 (C. C. A. 8th), certiorari denied, 282 U. S. 883; *Radiant Glass Co.* v. *Burnet*, 54 F. (2d) 718 (App. D. C.); *Dr. Pepper Bottling Co.* v. *Commissioner*, 69 F. (2d) 768 (C. C. A. 5th); *Safety Electric Products Co.* v. *Helvering*, 70 F. (2d) 439 (C. C. A. 9th).

An election to report income from long-term contracts on the completed contract basis permitted by the Commissioner's regulations is binding upon the taxpayer. *Bent* v. *Commissioner*, 56 F. (2d) 99 (C. C. A. 9th); *Rice, Barton & Fales* v. *Commissioner*, 41 F. (2d) 339 (C. C. A. 1st); *Ellis* v. *Commissioner*, 16 B. T. A. 1225; *R. G. Bent Co.* v. *Commissioner*, 26 B. T. A. 1369; *Hammond* v. *Commissioner*, 36 B. T. A. 497. Other permissible methods of reporting income which have been held to consti-

tute a binding election when adopted are illustrated by the cases of *Ramsey* v. *Commissioner*, 66 F. (2d) 316 (C. C. A. 10th), certiorari denied, 290 U. S. 673; *Moran* v. *Commissioner*, 67 F. (2d) 601 (C. C. A. 1st); *Momsen-Dunnegan-Ryan Co.* v. *Helvering*, 68 F. (2d) 754 (App. D. C.); *LeBolt & Co.* v. *United States*, 67 C. Cls. 422; *Russell-Miller Milling Co.* v. *Helvering*, 69 F. (2d) 392 (App. D. C.).

Similarly, the failure to choose the capital net gain rate of tax in a return "at the election of the taxpayer" under Section 101 of the 1928 Act is binding. *United States* v. *The National City Bank of New York* (S. D. N. Y.) reported in 1937 Prentice-Hall, paragraph 1517. But even if such a choice were not a binding election, since it merely involves choice of the rate of tax, the election not to use the installment basis is a binding election, because it involves the entire method of reporting income from installment sales and if not a binding election administration of the revenues will be impeded because readjustment of the income for the year of sale will require readjustment of the income for all subsequent years in which installment payments are made on the sale contract.

Moreover, the respondent, for a nominal consideration, assigned the sales contract, dated April 11, 1929, to his wife before August 12, 1931 (R. 5). Even if the respondent were permitted to use the installment basis, Section 44 (d) of the 1928 Act would apply and the respondent would be required to report the entire gain from the contract in the

year in which he made this disposition of it. The burden is on the respondent in this refund action to show that he overpaid the tax in 1929. He has not shown that the assignment was not made in 1929. If it was, the complete gain was taxable in that year.

The court below does not cite the numerous cases discussed above holding that the income tax return constitutes a binding election of a method of reporting installment sales. The cases cited by the court (R. 7) are distinguishable. The only two cases cited by the court below (*Davis* v. *United States*, 71 C. Cls. 444, 46 F. (2d) 377; *Schneider, Trustee* v. *Lucas*, 15 Am. Fed. Tax Rep. (W. D. Ky.) not officially reported, reversed 47 F. (2d) 1006 (C. C. A. 6th), certiorari denied, 284 U. S. 622) are distinguishable.

The opinion in the *Davis* case did not discuss election but found as a fact that the sales transactions in 1919 and 1920, which the taxpayer had treated in its return as one transaction creating a profit in 1920, were two transactions. The court held that this mistake of fact could be corrected by the taxpayer and then one of the sales could be reported on the installment basis. There had been no election as to that sale. In the present case there was only one sale in the tax year of 1929 and the respondent did elect to report that sale as a deferred payment sale not on the installment plan.

In the *Schneider* case election was not discussed by the courts. The bankrupt taxpayer had re-

ported the entire profit from a sale of real estate in 1925 for cash and the assumption of mortgages payable in later years. The trustee sought to have the income computed on the installment basis. The district court held that the contract price included the assumed mortgages but that profit was realized only as the mortgages were paid and, therefore, the installment method was applicable because initial payments were less than 25 percent of the sale price. The Sixth Circuit Court of Appeals held that the installment method was not applicable because the initial payments, including the mortgages to the extent that they exceeded the vendor's basis, were more than 25 percent of the sale price. Both courts seemed to assume that the installment basis was available to the taxpayer if the terms of the statute applied. Election between two applicable methods was not considered.

The principle of election, as established by the decisions discussed above, is based upon a choice of *method* afforded taxpayers by the statute or the regulations, and the necessity, in order to promote orderly administration in the assessment, collection, and refund of taxes, of requiring both the taxpayer and the Commissioner to abide by that choice when once made.[9]

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[9] Cf. *Lucas* v. *Sterling Oil & Gas Co.*, 62 F. (2d) 951 (C. C. A. 6th), where the taxpayer was not bound by a choice of method permitted by the regulations but made without sufficient knowledge of material facts and corrected by filing an amended return prior to filing the return for the succeeding year.

The taxpayer's election as to the method of reporting income is made when the return is filed. *Pathe Exchange* v. *Commissioner*, 77 F. (2d) 306 (C. C. A. 2d, Swan, J.); cf. *Bent* v. *Commissioner*, 56 F. (2d) 99 (C. C. A. 9th).

Clearly, we submit, the principle of election as established in the numerous cases cited above must be observed in order to avoid confusion in the administration of the tax laws. Whether income will thereby escape taxation, or the taxpayer in individual cases pay more tax because of his election, is not of controlling importance unless principles of estoppel are involved.

C. ANY OVERSTATEMENT OF INCOME FOR YEAR OF SALE MUST BE CORRECTED IN ACCORDANCE WITH METHOD EMPLOYED RATHER THAN BY CHANGE OF METHOD

The Court of Claims based its decision, in part at least, upon the conclusion that "the basis on which plaintiff reported the transaction in his return for 1929 * * * did not clearly reflect plaintiff's income." (R. 8.) In this the court was in error for several reasons.

In the first place, as already demonstrated, a taxpayer is required to make his return in accordance with the method of accounting employed—in this case the cash receipts and disbursements method—subject only to the condition that such method clearly reflects the income. The right to report the profit "realized or to be realized" upon certain deferred-payment sales in accordance with the pro-

visions of Section 44 of the Act is a privilege granted by the statute, available at the election of the taxpayer, and is not a requirement that must be complied with in order to clearly reflect the income.

In the second place, it is not shown that the respondent's return for 1929 did not clearly reflect the income for that year. The court's conclusion that respondent's 1929 return did not clearly reflect his income for that year is based entirely upon the fact that in 1932 "the contract of sale of the stock in question was changed and the then unpaid purchase price thereof was reduced to $75,000." (R. 8.) It does not follow, however, that because the amount of the unpaid purchase price was reduced in a subsequent year the income for the year of the sale was overstated. Section 111 (a) of the Revenue Act of 1928 provides, with certain exceptions not material here, that "the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113 * * *." The basis in the instant case is the cost of $46,000. Section 111 (c) defines the "amount realized" from the sale or other disposition of property as "the sum of any money received plus the fair market value of the property (other than money) received."

The terms of the 1929 contract are not disclosed in detail, but the findings disclose that it provided for a down payment of $25,000 and the payment of the balance of $225,000 in monthly installments of

$1,875 beginning October 1, 1929, together with interest. If the right to receive these future payments had a fair market value at the time of the sale equal to the amount of the unpaid balance of the purchase price there was no overstatement of income for 1929.[10] *Marr* v. *United States,* 268 U. S. 536; *Whitlow* v. *Commissioner,* 82 F. (2d) 569 (C. C. A. 8th); *Commissioner* v. *Moir,* 45 F. (2d) 356 (C. C. A. 7th).

In the third place, if respondent's income for 1929 was erroneously overstated his remedy was to

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[10] Sales of this character are usually either in the form of agreements of purchase and sale which contemplate that a transfer of title will not be made until all or a substantial portion of the purchase price has been paid, or sales in which there is an immediate transfer of title, the vendor being protected by a mortgage or other lien as to deferred payments. See Articles 351 and 352 of Treasury Regulations 74. But for the purpose of computing the taxable gain to be reported in the year of sale, where gain is realized in that year, no distinction is made between cases where the transfer of title is deferred until payment of the purchase price is received and cases where title is transferred subject to a lien. Cf. *Burnet* v. *Logan*, 283 U. S. 404; *Wells Amusement Co.* v. *Commissioner*, 70 F. (2d) 208 (C. C. A. 4th); *Stiles* v. *Commissioner*, 69 F. (2d) 951 (C. C. A. 5th); *Ives Dairy* v. *Commissioner*, 65 F. (2d) 135 (C. C. A. 5th); *Trust No. 5522, Etc., Security-First Nat. Bank* v. *Commissioner*, 27 B. T. A. 1250, reversed on another point, 83 F. (2d) 801 (C. C. A. 9th); *Titus* v. *Commissioner*, 33 B. T. A. 928, petition for review dismissed, 88 F. (2d) 1007 (C. C. A. 10th); *Doric Apartment Co.* v. *Commissioner*, 32 B. T. A. 1187; *Lloyd* v. *Commissioner*, 33 B. T. A. 903; *Cambria Development Co.* v. *Commissioner*, 34 B. T. A. 1155; *Greenwood* v. *Commissioner*, 34 B. T. A. 1209; *Hobbs* v. *Commissioner*, 26 B. T. A. 241; *Rapid Transit Land Sales Co.* v. *Commissioner*, 20 B. T. A. 608; *Woodmar Realty Co.* v. *Commissioner*, 17 B. T. A. 88.

have it corrected, by a proper refund claim, in accordance with the method of reporting gain which was chosen in making his return, rather than to have his gross income redetermined in accordance with the alternative method which he might have chosen originally.

As already stated, it is not shown that the cash receipts and disbursements "method of accounting" employed by the respondent would not clearly reflect his income if properly applied. Adjustments to income may be made in accordance with the "method" employed in order to clearly reflect the income. *United States* v. *American Can Co., supra.* Such adjustment could have been made by subsequent claim if it later developed that the initial statement was based upon erroneous facts. *Continental Tie & L. Co.* v. *United States,* 282 U. S. 290, 295; *Williams* v. *Commissioner,* 45 F. (2d) 61 (C. C. A. 5th). If the value assigned to the right to receive the deferred payments was overstated that error could be corrected.[11] On the other hand, if the right to receive future payments had no value, or if, as this Court found in *Burnet* v. *Logan,* 283 U. S. 404, 413, the promise to make

[11] *Wells Amusement Co.* v. *Commissioner*, 70 F. (2d) 208 (C. C. A. 4th); *Stiles* v. *Commissioner*, 69 F. (2d) 951 (C. C. A. 5th); *Ives Dairy* v. *Commissioner*, 65 F. (2d) 135 (C. C. A. 5th); *Trust No. 5522, Etc., Security-First Nat. Bank* v. *Commissioner*, 27 B. T. A. 1250, reversed on another point, 83 F. (2d) 801 (C. C. A. 9th); *Doric Apartment Co.* v. *Commissioner*, 32 B. T. A. 1187; *Rapid Transit Land Sales Co.* v. *Commissioner*, 20 B. T. A. 608.

future payments was "wholly contingent upon facts and circumstances not possible to foretell with anything like fair certainty" no amount would be includible in gross income on account of the contract for future payments.[12] Any adjustments to income made necessary by the reduction in the amount of the unpaid payments in 1932 should be reflected in the return of that or some subsequent year after the 1929 income is properly determined in accordance with the return. This reduction in the net sales price does not require or justify computation of 1929 income on a basis different from that chosen when the return was filed.

D. A GENERAL RULE WHICH WOULD PERMIT SUBSEQUENT CHANGE OF POSITION AND USE OF ALTERNATIVE METHOD OF REPORTING GAIN FOR THE YEAR OF SALE WOULD IMPEDE ADMINISTRATION OF THE REVENUES

The Government's position is based upon the doctrine of election and not upon estoppel.

The installment sales provisions do not propose a requirement which is essential in order clearly to reflect the income. They contemplate a consistent treatment of proceeds from deferred-payment sales which extend over a period of years. Such consistency can be insured only by requiring the tax-

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[12] *Titus* v. *Commissioner*, 33 B. T. A. 928, petition for review dismissed, 88 F. (2d) 1007 (C. C. A. 10th); *Lloyd* v. *Commissioner*, 33 B. T. A. 903; *Cambria Development Co.* v. *Commissioner*, 34 B. T. A. 1155; *Greenwood* v. *Commissioner*, 34 B. T. A. 1209; *Woodmar Realty Co.* v. *Commissioner*, 17 B. T. A. 88; *Graves* v. *Commissioner*, 17 B. T. A. 1318.

payer to abide by his original choice of method for reporting such gains. If, after the lapse of a period of time, the taxpayer is permitted to have his income for the year of the sale redetermined by the use of the alternative method consistency in the treatment of installment sales could be insured only by permitting or requiring the Commissioner of Internal Revenue to redetermine the correct income for all years subsequent to the year of the sale in which payments are received. This procedure obviously would entail a great administrative burden.

The principle of election as applied in this and other situations, while sometimes resulting in a larger tax to the individual taxpayer or a loss of revenue to the Government, is fair and useful. It should be sustained in the instant case.

CONCLUSION

The decision of the court below is wrong and should be reversed.

Respectfully submitted.

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JAMES W. MORRIS,
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FEBRUARY, 1938.

APPENDIX

Revenue Act of 1926, c. 27, 44 Stat. 9:

NET INCOME OF INDIVIDUALS DEFINED

SEC. 212. (d) Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the total profit realized or to be realized when the payment is completed, bears to the total contract price. In the case (1) of a casual sale or other casual disposition of personal property for a price exceeding $1,000, or (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed one-fourth of the purchase price, the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this subdivision. As used in this subdivision the term "initial payments" means the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made.

INSTALLMENT SALES

SEC. 1208. The provisions of subdivision (d) of section 212 shall be retroactively applied in computing income under the pro-

visions of the Revenue Act of 1916, the Revenue Act of 1917, the Revenue Act of 1918, the Revenue Act of 1921, or the Revenue Act of 924, or any of such Acts as amended. Any tax that has been paid under such Acts prior to the enactment of this Act, if in excess of the tax imposed by such Acts as retroactively modified by this section, shall, subject to the statutory period of limitations properly applicable thereto, be credited or refunded to the taxpayer as provided in section 284.

Revenue Act of 1928, c. 852, 45 Stat. 791:

PART II. COMPUTATION OF NET INCOME

SEC. 21. NET INCOME.

"Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

SEC. 22. GROSS INCOME.

(a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

* * * * *

(e) *Determination of gain or loss.*—In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in sections 111, 112, and 113.

* * * * *

PART IV. ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period.

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits provided for in this title shall be taken for the taxable year in which "paid or accrued" or "paid or incurred", dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or

credits should be taken as of a different period.

SEC. 44. INSTALLMENT BASIS.

(a) *Dealers in personal property.*—Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price.

(b) *Sales of realty and casual sales of personalty.*—In the case (1) of a casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year), for a price exceeding $1,000, or (2) of a sale or other disposition of real property if in either case the initial payments do not exceed 40 per centum of the selling price, the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this section. As used in this section the term "initial payments" means the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made.

(c) *Change from accrual to installment basis.*—If a taxpayer entitled to the benefits of subsection (a) elects for any taxable year to report his net income on the installment basis, then in computing his income for the

year of change or any subsequent year, amounts actually received during any such year on account of sales or other dispositions of property made in any prior year shall not be excluded.

* * * * *

PART V. RETURNS AND PAYMENT OF TAX

SEC. 51. INDIVIDUAL RETURNS

(a) *Requirement.*—The following individuals shall each make under oath a return stating specifically the items of his gross income and the deductions and credits allowed under this title—

(1) Every individual having a net income for the taxable year of $1,500 or over, if single, or if married and not living with husband or wife;

(2) Every individual having a net income for the taxable year of $3,500 or over, if married and living with husband or wife; and

(3) Every individual having a gross income for the taxable year of $5,000 or over, regardless of the amount of his net income.

(b) *Husband and wife.*—If a husband and wife living together have an aggregate net income for the taxable year of $3,500 or over, or an aggregate gross income for such year of $5,000 or over—

(1) Each shall make such a return, or

(2) The income of each shall be included in a single joint return, in which case the tax shall be computed on the aggregate income.

* * * * *

SUPPLEMENT B. COMPUTATION OF NET INCOME

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

(a) *Computation of gain or loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.

* * * * *

(c) *Amount realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(d) *Recognition of gain or loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title shall be determined under the provisions of section 112.

(e) *Installment sales.*—Nothing in this section shall be construed to prevent (in the case of property sold under contract providing for payment in installments) the taxation of that portion of any installment payment representing gain or profit in the year in which such payment is received.

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

* * * * *

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * *

Treasury Regulations 74:

ART. 321. *Computation of net income.*—Net income must be computed with respect to a fixed period. Usually that period is 12 months and is known as the taxable year. Items of income and of expenditures which as gross income and deductions are elements in which the computation of net income need not be in the form of cash. It is sufficient that such items, if otherwise properly included in the computation, can be valued in terms of money. The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the tapayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. (See articles 331–333.) If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation shall be made in such manner as in the opinion of the Commissioner clearly reflects it.

ART. 322. *Bases of computation.*—Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income. A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency. See section 48 for definitions of "paid or accrued" and "paid or incurred." All items of gross income shall be included in the gross income for the taxable year in which they are received by the taxpayer, and deductions taken accordingly, unless in order clearly to reflect income such amounts are to be properly accounted for as of a different period. * * *.

ART. 331. *When included in gross income.*—Gains, profits, and income are to be included in the gross income for the taxable year in which they are received by the taxpayer, unless they are included as of a different period in accordance with the approved method of accounting followed by him. * * *

ART. 351. *Sale of personal property on installment plan.*—

* * * * *

In the case of a casual sale or other casual disposition of personal property other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, for a price exceeding $1,000, income may be returned on the installment basis provided the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale or other disposition

is made do not exceed 40 per cent of the selling price.

If for any reason the purchaser defaults in any of his payments, and the vendor returning income on the installment basis repossesses the property, the entire amount received in installment payments and retained by the vendor, less the sum of the profits previously returned as income and an amount representing proper allowance for damage and use, if any, will be income of the vendor for the year in which the property is repossessed, and the property repossessed must be carried on the books of the vendor at its original cost, less proper allowance for damage and use, if any.

If the vendor chooses as a matter of consistent practice to return the income from installment sales on the straight accrual or cash receipts and disbursements basis, such a course is permissible.

If an installment obligation is satisfied, or otherwise disposed of, gain or loss may result therefrom and must be determined in accordance with section 44 (d) and article 355.

ART. 355. *Gain or loss upon disposition of installment obligations.*—If an installment obligation is satisfied at other than its face value or is sold or exchanged, gain or loss results to the extent of the difference between (1) the excess of the face value of the obligation over the amount of income which would be returnable were the obligation satisfied in full and (2) the amount realized upon such disposition.

If an installment obligation is distributed, transmitted, or disposed of otherwise than by sale or exchange, gain or loss results to

the extent of the difference between (1) the excess of the face value of the obligation over the amount of income which would be returnable were the obligation satisfied in full and (2) the fair market value of the obligation at the time of such distribution, transmission, or disposition.

The entire amount of gain or loss resulting from the disposition or satisfaction of installment obligations shall be recognized except as provided in section 112 and articles 571–580.

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IN THE

Supreme Court of the United States

October Term 1937

No. 667.

United States of America,
Petitioner,

v.

Harry A. Kaplan,
Respondent.

BRIEF OF RESPONDENT IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

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OCTOBER TERM 1937

No. 667.

UNITED STATES OF AMERICA,
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v.

HARRY A. KAPLAN,
Respondent.

BRIEF OF RESPONDENT IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

Opinion Below.

The special findings of fact, conclusions of law, and opinion of the Court of Claims are reported in 18 F. Supp. 965.

Jurisdiction.

The judgment of the Court of Claims was entered April 26, 1937. A motion for a new trial was filed by the United States on June 24, 1937, and was denied by the Court on October 4, 1937. The jurisdiction of this Court is invoked under Section 3 (b) of the Act of February 13, 1925.

Questions Presented.

During the year 1929 the respondent sold 25 shares of stock in "1100 Park Avenue" for $250,000.00 and paid a commission on said sale of $10,000.00, leaving a net selling price of $240,000.00. The 25 shares of stock cost the respondent $46,000.00. The respondent reported on his Federal income tax return the sum of $194,000.00 as profit on the sale taxable for the year 1929. Said reported profit on the sale was computed by respondent by subtracting $46,000.00 (cost price) from $240,000.00 (net selling price).

However, under the terms of the agreement of sale the respondent received $25,000.00 down on the date of the sale of the stock and the balance of the purchase price was payable by the vendee in monthly installments of $1,875.00 each over a period of ten years.

In all, the respondent received from the sale during the year 1929 the sum of $30,625.00, which was less than 40 per cent of the amount of the purchase price of $250,000.00.

The Internal Revenue Agent in Charge at New York City subsequently notified the plaintiff that an over-assessment of $2,084.20 for the year 1929 would be recommended on the basis of the respondent's right to report the profit from the sale on the installment basis.

The respondent thereafter filed a claim for refund, which was denied by the Commissioner of Internal Revenue, on the ground that the respondent had no right to compute the profit on the installment basis after filing his return and showing a profit of $194,000. The respondent for the year 1929 kept his accounts and filed his Federal income tax return on the cash receipts and disbursements basis.

The case therefore presents the following questions:

I.

Whether a profit of $194,000 truly, correctly and reasonably reflects the respondent's income from the sale for the year 1929.

II.

Whether the respondent's error in reporting excessive income for the year 1929 may be corrected by the filing of a claim for refund.

III.

Whether the respondent is precluded from claiming the installment method for reporting profit on the sale by having filed his return on the basis of a completed profit of $194,000.

Statute and Regulations Involved.

The pertinent statute and regulations involved in this case are printed in the Appendix, *infra*, p. 13.

Statement.

The Court of Claims made the following special findings of fact:

1. A joint income tax return of plaintiff, Harry A. Kaplan, and his wife, Ethel, for the year 1929 was filed March 15, 1930, indicating a total tax of $2,084.20 which was paid—$584.20 on March 17, 1930, and the balance of $1,500 in the amount of $500 each on June 13 and October 16, 1930, and $500 on July 23, 1931. For 1929 and all subsequent years plaintiff kept his books of account and made his Federal tax returns on the cash receipts and disbursements basis.

Included in the gross income in the return was an amount of $194,000, being the difference between a net selling price of $240,000 and a purchase price of $46,000 paid in June 1928 for shares of stock in "1100 Park Avenue" which Harry A. Kaplan, April 11, 1929, agreed to sell under a contract whereby the purchaser was to pay $250,000 as follows: $25,000 down and $225,000 in monthly installments of $1,875 beginning October 1, 1929, together with interest, the shares in the meantime to be deposited in escrow. The plaintiff in 1929 paid $10,000 commission

on the transaction, making the net selling price to him \$240,000. On December 28, 1929, plaintiff agreed to an assignment made September 23, 1929, by the purchaser of his obligations under the contract to a third party, the Comas Holding Corporation.

During 1929 plaintiff received from the purchaser or his assignee \$30,625 on the sales contract; in 1930 he received \$22,500 in monthly installments of \$1,875; and in the first three months of 1931, \$5,601.51, after which time the agreed payments ceased. By agreement of August 12, 1931, between Ethel Kaplan, to whom plaintiff has assigned his interest in the contract for a nominal consideration, and the Comas Holding Corporation, the balance of \$191,273.49 was to be paid \$2,273.49 down and \$2,000 monthly beginning September 1, 1931. In 1931 there was paid to plaintiff on the revised agreement \$6,273.49 to the end of October, at which time payments again ceased. A further agreement was entered into March 19, 1932, between Ethel Kaplan and the Samuel Silver Realty Co., Inc., whereby the former agreed to sell the same shares of stock to the latter for \$75,000, payable \$750 down and the balance in monthly installments of \$750 beginning April 10, 1932.

2. Plaintiff filed a joint income tax return for himself and wife for 1930 on March 16, 1930, showing no taxable income and no sale of stock in "1100 Park Avenue" or profit or loss thereon. Plaintiff filed no income tax return either for 1931 or 1932.

3. Internal Revenue Agent in Charge, R. T. Miles, New York City, notified plaintiff by letter November 18, 1931, of his decision, after audit and investigation of the 1929 return, to recommend an overassessment of \$2,084.20 for 1919 (the record shows this date to be 1919, but it should be 1929) conceding plaintiff's right to compute the tax on the sale here involved on the installment basis.

February 29, 1932, the Commissioner of Internal Revenue notified plaintiff of his disapproval of the internal

revenue agent's report and stated that no overassessment was disclosed.

4. March 12, 1932, plaintiff filed a claim for the refund of $2,084.20 for 1920, (the record shows this date to be 1920, but it should be 1929) on the ground that he was lawfully entitled to report the stocks-sale transaction on the installment basis. The Commissioner of Internal Revenue rejected this claim January 23, 1933.

Argument.

I.

No important question of Federal tax law is presented.

The issues in this case involve questions of fact and not substantial questions of law.

The Court of Claims found that the respondent erroneously and mistakenly reported a profit of $194,000 on the transaction herein involved in his return for the calendar year 1929 (R. 7).

The Court of Claims also found that the basis upon which the respondent reported the transaction in his return for the year 1929 did not clearly reflect the respondent's income (R. 8.)

The Court stated, in part, as follows (R. 8):

> "* * * Moreover, the basis on which plaintiff reported the transaction in his return for 1929 and the basis on which the Bureau held him taxable when the claim for refund was finally rejected in 1933 did not clearly reflect plaintiff's income. In March, 1932, almost a year before the Commissioner rejected plaintiff's refund claim, the contract of sale of the stock in question was changed and the then unpaid purchase price thereof was reduced to $75,000. *The maximum amount which plaintiff therefore could ever receive under the contract for sale of the stock was $139,999 instead of a net selling price of $240,000, which is $54,000 in excess of the sum stated as profit in the return for 1929.* * * *"

(Italics supplied.)

One of the objects of the statute providing for the filing of claims for refund is to enable a taxpayer to correct errors of fact (*Davis* v. *United States*, 71 C. Cls. 444, 46 F. (2d) 377.)

Accordingly the Court of Claims held that the respondent was entitled to correct the errors which he had made and to file a claim for refund and recover thereon.

II.

Section 44 of the Revenue Act of 1928 definitely gives to a taxpayer the right to report income from a casual sale of personal property on the installment basis. The mistake of this taxpayer in returning a fictitious profit, which did not truly and correctly reflect his income, did not constitute a binding election.

The wording of the law (Section 44, Revenue Act of 1928) which grants the taxpayer the privilege of reporting such a sale on the installment basis discloses no intent on the part of Congress to make a choice of one method or the other a binding election. The statute does not even use the word "election" in reference to installment sales of property. The statute merely states that the income from such a sale may be reported in the manner prescribed. Likewise, the Regulations (Regulations 74, Articles 352 and 353) do not even imply that a choice of reporting one or the other method in reporting the sale of property shall be construed as a binding election. There is nothing in the law or the regulations which makes respondent's original choice a binding election or which justifies the action of the Commissioner of Internal Revenue in refusing to allow respondent to make the change which he requested.

Furthermore, the situation presented here is analogous to that presented under the capital net gain provision of Section 101 of the Revenue Act of 1928. That section provides:

> "In the case of any taxpayer other than a corporation who for any taxable year derives a capital net gain (as hereinafter defined in this section), there shall, *at*

the election of the taxpayer, be levied, collected and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½% of the capital net gain." (Italics supplied.)

In other words, the taxpayer may pay a tax at the rate of 12½% of his capital net gain or may report the capital net gain as ordinary income and pay the ordinary tax rate on it. It should be noted that this section specifically provides that the taxpayer shall *elect* the method which he desires to use. In spite of the use of the phrase "election of the taxpayer" in the statute, it has been consistently held by the Bureau of Internal Revenue and by the Board of Tax Appeals that a choice of one or the other method is not a binding election but may be changed after the return is filed, if it is advantageous to the taxpayer to do so. In G. C. M. 2367, Int. Rev. Cumulative Bulletin VI-2, page 172, in considering Section 206 (b) of the Revenue Act of 1921, which corresponds to Section 101 of the Revenue Act of 1928, the General Counsel of the Bureau of Internal Revenue stated in said Cumulative Bulletin:

> "It was evidently the purpose of section 206(b) of the Revenue Act of 1921 to allow taxpayers with respect to capital gains to compute the tax either under that section or under sections 210 and 211 whichever would produce the lesser tax. The parenthetical expression 'at the election of the taxpayer' as used in section 206(b) carried out this purpose and does not imply a technical election which once made is binding on the taxpayer. No real election is involved; that is, no election between two desirable alternatives, since obviously all taxpayers will desire to avail themselves of section 206 if it results in a lesser tax. In such a case, if that section is not availed of, it must be through ignorance or mistake."

In that memorandum the General Counsel ruled that a taxpayer who had filed his original return reporting his

capital net gain as ordinary income should be allowed to amend his return and be taxed at the rate of 12½% on his capital net gain. In G. C. M. 13466, published in September, 1934, in Internal Revenue Bulletin, Vol. XIII-1, page 144, the above rule was held to apply where at the time the original return was filed it was to the advantage of the taxpayer to return his capital net gain as ordinary income, but upon an audit of his return and an increase of his ordinary income, it became advantageous to the taxpayer to change his method of reporting said income and be taxed on his capital net gain at 12½%.

The above quoted portion of G. C. M. 2367 was approved and the rule reiterated as follows:

> "The conclusions reached in the foregoing rulings were based upon the theory that where a taxpayer has the right to be taxed at one of two rates he will always choose the lower rate, and that the 'election' to have capital gains so taxed really means the right to have such income taxed at the capital gain rate if it is more advantageous to the taxpayer. If the taxpayer does not elect to be taxed at the lower rate it will doubtless be due to ignorance or mistake and he should have the right to elect with full knowledge of all the facts and the consequences of an election. The possibility of a taxpayer electing to be taxed at the higher rate is too remote for contemplation."

See also I. T. 2132, IV-1 C. B. 117, *James F. Hoey* v. *Comm.*, 4 B. T. A. 1043; *Fifth Third Union Trust Co.* v. *Comm.*, 20 B. T. A. 88.

The reasons advanced by the General Counsel in the above quotations in support of his ruling, that a choice of one of the two methods of reporting capital net gain does not constitute an election, apply with equal force to Section 44 of the Revenue Act of 1928 and support respondent's contention in regard to that section of the law. It is equally true that in the case of an installment sale of property all taxpayers would desire to avail themselves of the method which would result in the lesser tax and a failure to do so "must

be through ignorance or mistake'' and therefore there is no election between two desirable alternatives. There is no sound reason why a choice under Section 44 of the Revenue Act of 1928 should constitute a binding election when a choice under Section 101 of the same Act does not constitute a binding election, especially since Section 101 specifically provides that the method used shall be "at the election of the taxpayer." It is submitted that Congress did not intend that a choice by a taxpayer of one of the two methods allowed for the reporting of income from an installment sale of property should constitute a binding election, and that the Commissioner erred in so ruling and in refusing to allow respondent to correct the error made in the original return.

The instant case is distinguishable from the line of cases involving taxpayers on the accrual basis. If this taxpayer had been on the accrual basis of accounting and had reported the profit on the accrual basis as income for 1929, his return might have been correct for it would have reflected the profit for 1929 on the accrual basis of accounting. Accordingly he would not have had any error to correct by filing a claim for refund.

However, this taxpayer is on the cash basis of accounting. On that basis he did not derive a profit of $194,000 from the sale in 1929. On a cash basis his income for the year 1929 is distorted by reporting a profit of $194,000. On the accrual basis of accounting such a profit would perhaps have been correct. Therefore, inasmuch as the respondent reported for the year 1929 on a cash basis and reflected an erroneous and unreasonable profit from the sale, he is entitled to correct this error by means of a claim for refund. *Davis* v. *United States, supra.*

The United States Board of Tax Appeals has pointed out in a number of cases that a taxpayer is not irrevocably bound by electing to report income on an erroneous basis which either distorts income or fails to truly and correctly reflect income.

In *Key Largo Shores Properties, Inc.* v. *Commissioner of Internal Revenue*, 21 B. T. A. 1008, the Board of Tax Appeals said:

> "The fact that petitioner originally reported income from the sale of real estate on the installment basis does not preclude it from changing to the deferred payment basis where the installment basis does not correctly reflect income."

In the course of its opinion the Board declared as follows on page 1012 of 21 B. T. A.:

> "Under the Revenue Acts various methods of reporting income may be adopted by taxpayers, but all are designed to correctly reflect the true income in order that a just tax may be levied and collected. If a method used by a taxpayer does not clearly reflect income, the respondent may determine the income according to a method which in his opinion does clearly reflect it. Section 212, Revenue Act of 1926. This in itself is sufficient to demonstrate that it was not intended that taxpayers should be irrevocably bound by the election of a method of reporting when that method is erroneous. The effect in this case of requiring adherence to the basis originally adopted by the taxpayer would be to set up and tax, as income, an amount which in fact is not income. Neither administrative rules nor the forceful arguments in favor of administrative expediency can create income where in fact there is none, and, after all, it is only income that is to be taxed. In our opinion the installment basis when applied to the facts in the present case does not reflect the taxpayer's income."

In *Boone et al.* v. *Commissioner*, 27 B. T. A. 1064, the Board held that where income was originally reported on the accrual basis the taxpayer could later change to the installment basis in order to clearly reflect income. At page 1067 of 27 B. T. A. the Board said:

> "Respecting respondent's contention that because petitioners in their return for 1920 reported the profit

from the sale on an accrual basis they cannot now change to the installment basis, we again disagree. We have previously held that there was no statutory authority for reporting income on the installment basis under the Revenue Act of 1918, B. B. Todd, Inc., 1 B. A. 762; H. B. Graves Co., 1 B. T. A. 859; Hoover-Bond Co., 1 B. T. A. 929. Obviously, therefore, when petitioners filed their returns for 1920 they had no right to report the income from this sale on the installment basis. This privilege was accorded them by the provisions of section 212 (d) of the Revenue Act of 1926 as retroactively applied by section 1208 of the same act. To hold that petitioners can not change the method of reporting this installment sale would be contrary to the intention of Congress as expressed in these sections. Laurence H. Lucker, 21 B. T. A. 93; Potter Farms, Inc., 6 B. T. A. 111; Standard Computing Scale Co. v. United States, 52 Fed. (2d) 1018; M. L. Elken, 7 B. T. A. 1160; R. L. Brown Coal & Coke Co., 14 B. T. A. 609. Cf. Key Largo Shores Properties, Inc., 21 B. T. A. 1008."

III.

The facts in this case are distinguishable from the facts in *Pacific National Company* v. *Welch*, 91 F. (2) 590. The petitioner relies on the decision of the United States Circuit Court of Appeals for the Ninth Circuit in *Pacific National Company* v. *Welch*, 91 F. (2d) 590, and cites that case as the basis for the granting of a writ of certiorari in this case. The Court found as a fact in the Pacific National Company case that the taxpayer reported the sales there involved in its income tax return, just as the sales were reflected upon the books of the taxpayer; that is, the taxpayer company treated the sales on its books as deferred payment sales and measured its book income accordingly. There was no finding by the Court that either the books of the taxpayer or its return failed to truly and correctly reflect income. The Pacific National Company subdivided real property and sold the subdivision lots for 25 per cent down and the balance over a period of time and the obligations

of the various purchasers of the lots were treated as having a fair market value equivalent to their face value.

In the instant case but one transaction is involved; that is one casual sale of stock. The respondent is an individual and he did not have a set of books reflecting sales of property on a deferred payment basis as did the Pacific National Company. All the sums he received in 1929 were the cash payments made by the vendee and a contract of sale providing for the further payments.

The Court of Claims found in the case at bar that the return of the taxpayer for the year 1929 (showing a profit of $194,000 from the sale) did not truly and correctly reflect the taxpayer's income. The Court further found that the taxpayer erroneously and mistakenly reported in his return for 1929 a profit from the transaction of $194,000.

Wherefore, it is submitted that the reasons advanced by the petitioner for the granting of a writ of certiorari are not sound and the petition should be denied.

Respectfully submitted,

Llewellyn A. Luce,
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APPENDIX.

Statutes and Regulations Involved.

The Revenue Act of 1928 provides as follows:

"(a) Dealers in Personal Property—Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price.

"(b) Sales of realty and casual sales of personalty—In the case (1) of a casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year), for a price exceeding $1,000, or (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed 40 per centum of the selling price, the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this section. As used in this section the term 'initial payments' means the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made.

"(c) Change from accrual to installment basis.—If a taxpayer entitled to the benefits of subsection (a) elects for any taxable year to report his net income on the installment basis, then in computing his income for the year of change or any subsequent year, amounts actually received during any such year on account of sales or other disposition of property made in any prior year shall not be excluded."

Article 351 of Treasury Regulations 74 promulgated under the Revenue Act of 1928 provides, in part:

> "* * * In the case of a casual sale or other casual disposition of personal property other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, for a price exceeding $1,000, income may be returned on the installment basis provided the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale or other disposition is made do not exceed 40 per cent of the selling price. * * *".

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IN THE

Supreme Court of the United States

October Term, 1937.

No. 667.

United States of America, *Petitioner*,

v.

Harry A. Kaplan, *Respondent*.

On Writ of Certiorari to the Court of Claims.

BRIEF FOR RESPONDENT.

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CASES CITED.

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BRIEF FOR RESPONDENT.

OPINION BELOW.

The special findings of fact, conclusions of law, and opinion of the Court of Claims are reported in 18 F. Supp. 965.

JURISDICTION.

The judgment of the Court of Claims was entered April 26, 1937. A motion for a new trial was filed by the United States on June 24, 1937, and was denied by the Court on October 4, 1937. Petition for certiorari was granted by

this Honorable Court on February 14, 1938, and the case was assigned for argument immediately following No. 528, *Pacific National Company* v. *Welch, Former Collector.* The jurisdiction of this Court is invoked under Section 3 (b) of the Act of February 13, 1925.

QUESTIONS PRESENTED.

During the year 1929 the respondent sold 25 shares of stock in "1100 Park Avenue" for $250,000.00 and paid a commission on said sale of $10,000.00, leaving a net selling price of $240,000.00. The 25 shares of stock cost the respondent $46,000.00. The respondent reported on his Federal income tax return for 1929 the sum of $194,000.00 as profit on the sale taxable for the year 1929. Said reported profit on the sale was computed by respondent by subtracting $46,000.00, cost price, from $240,000.00, net selling price (R. 5).

However, under the terms of the agreement of sale the respondent received $25,000.00 down on the date of the sale of the stock and the balance of the purchase price was payable by the vendee in monthly installments of $1,875.00 each over a period of ten years (R. 5).

In all, the respondent received from the sale during the year 1929 the sum of $30,625.00, which was less than 40 per cent of the amount of the purchase price of $250,000.00 (R. 5).

The Internal Revenue Agent in Charge at New York City subsequently notified the plaintiff that an over-assessment of $2,084.20 for the year 1929 would be recommended on the basis of the respondent's right to report the profit from the sale on the installment basis (R. 5).

The respondent thereafter filed a claim for refund, which was denied by the Commissioner of Internal Revenue, on the ground that the respondent had no right to compute the profit on the installment basis after filing his return and showing a profit of $194,000. The respondent for the year 1929 kept his accounts and filed his Federal income

tax return on the cash receipts and disbursements basis (R. 5).

The case therefore presents the following questions:

I.

Whether a profit of $194,000 truly, correctly and reasonably reflects the respondent's income from the sale for the year 1929.

II.

Whether the respondent's error in reporting excessive income for the year 1929 may be corrected by the filing of a claim for refund.

III.

Whether the respondent is precluded from claiming the installment method for reporting profit on the sale by having filed his return on the basis of a completed profit of $194,000.

STATUTE AND REGULATIONS INVOLVED.

The pertinent statute and regulations involved in this case are printed in the Appendix, *infrà*, p. 19.

STATEMENT.

The Court of Claims made the following special findings of fact:

1. A joint income tax return of plaintiff, Harry A. Kaplan, and his wife, Ethel, for the year 1929 was filed March 15, 1930, indicating a total tax of $2,084.20, which was paid —$584.20 on March 17, 1930, and the balance of $1,500 in the amount of $500 each on June 13 and October 16, 1930, and $500 on July 23, 1931. For 1929 and all subsequent years plaintiff kept his books of account and made his Federal tax returns on the cash receipts and disbursements basis.

Included in the gross income in the return was an amount of $194,000, being the difference between a net selling price of $240,000 and a purchase price of $46,000 paid in June, 1928, for shares of stock in "1100 Park Avenue" which Harry A. Kaplan, April 11, 1929, agreed to sell under a contract whereby the purchaser was to pay $250,000 as follows: $25,000 down and $225,000 in monthly installments of $1,875 beginning October 1, 1929, together with interest, the shares in the meantime to be deposited in escrow. The plaintiff in 1929 paid $10,000 commission on the transaction, making the net selling price to him $240,000. On December 28, 1929, plaintiff agreed to an assignment made September 23, 1929, by the purchaser of his obligations under the contract to a third party, the Comas Holding Corporation.

During 1929 plaintiff received from the purchaser or his assignee $30,625 on the sale contract; in 1930 he received $22,500 in monthly installments of $1,875; and in the first three months of 1931, $5,601.51, after which time the agreed payments ceased. By agreement of August 12, 1931, between Ethel Kaplan, to whom plaintiff has assigned his interest in the contract for a nominal consideration, and the Comas Holding Corporation, the balance of $191,273.49 was to be paid $2,273.49 down and $2,000 monthly beginning September 1, 1931. In 1931 there was paid to plaintiff on the revised agreement $6,273.49 to the end of October, at which time payments again ceased. A further agreement was entered into March 19, 1932, between Ethel Kaplan and the Samuel Silver Realty Co., Inc., whereby the former agreed to sell the same shares of stock to the latter for $75,000, payable $750 down and the balance in monthly installments of $750 beginning April 10, 1932.

2. Plaintiff filed a joint income tax return for himself and wife for 1930 on March 16, 1930, showing no taxable income and no sale of stock in "1100 Park Avenue" or profit or loss thereon. Plaintiff filed no income tax return either for 1931 or 1932.

3. Internal Revenue Agent in Charge, R. T. Miles, New York City, notified plaintiff by letter November 18, 1931, of his decision, after audit and investigation of the 1929 return, to recommend an over-assessment of $2,084.20 for 1919 (the record shows this date to be 1919, but it should be 1929) conceding plaintiff's right to compute the tax on the sale here involved on the installment basis.

February 29, 1932, the Commissioner of Internal Revenue notified plaintiff of his disapproval of the internal revenue agent's report and stated that no over-assessment was disclosed.

4. March 12, 1932, plaintiff filed a claim for the refund of $2,084.20 for 1920, (the record shows this date to be 1920, but it should be 1929) on the ground that he was lawfully entitled to report the stock-sale transaction on the installment basis. The Commissioner of Internal Revenue rejected this claim January 23, 1933.

The Court also found (R. 8):

> "Moreover, the basis on which plaintiff reported the transaction in his return for 1929 and the basis on which the Bureau held him taxable when the claim for refund was finally rejected in 1933 did not clearly reflect plaintiff's income. In March, 1932, almost a year before the Commissioner rejected plaintiff's refund claim, the contract of sale of the stock in question was changed and the then unpaid purchase price thereof was reduced to $75,000. The maximum amount which plaintiff therefore could ever receive under the contract for sale of the stock was $139,999 instead of a net selling price of $240,000, which is $54,000 in excess of the sum stated as profit in the return for 1929."

SUMMARY OF ARGUMENT.

I.

The profit of $194,000 from the sale reported by the respondent in his income tax return for the year 1929 did not truly, correctly or reasonably reflect the respondent's income for the year 1929.

II.

The basis adopted by the respondent for reporting the transaction in his 1929 income tax return did not constitute a binding election because the method used did not truly and correctly reflect the respondent's income.

III.

The cases relied on by the Commissioner are distinguishable from the case at bar inasmuch as they involve one of the following situations:

(a) The basis originally used by the taxpayer in reporting income did truly and correctly reflect income.

(b) Efforts by affiliated corporations to change from a consolidated return basis to a separate return basis or vice versa without the permission of the Commissioner although the returns originally filed correctly reflected income.

(c) Efforts of married persons to change from individual to joint returns or vice versa although the original returns filed correctly reflected income.

IV.

The question here involved is largely one of fact and we believe that the findings of fact of the Court of Claims should not, under the decisions of this Honorable Court, be disturbed upon appeal. The record sent up to this Court upon appeal does not contain the transcript of testimony

or the exhibits upon which the findings of the Court of Claims were based and there is no showing in this cause that the findings of fact of the Court of Claims were not based upon substantial evidence.

ARGUMENT.

I.

The Profit of $194,000 From the Sale Reported by the Respondent in His Income Tax Return for the Year 1929 Did Not Truly, Correctly, or Reasonably Reflect the Respondent's Income for the Year 1929.

The record discloses that the contract of sale provided for a total purchase price for the stock of $250,000. Of the said sum ($250,000), $25,000 was paid in cash on or about the date of sale and the balance, $225,000, was to be paid by the vendee in monthly installments of $1,875, over a period of ten years (R. 5).

The total amount collected under the contract by the respondent during the year 1929 was $30,625, which was less than 40 per cent of the purchase price of the stock. Also, during the year 1929, as found by the Commissioner, the respondent paid a brokerage fee of $10,000 in connection with the sale (R. 5).

During the year 1930 the respondent received $22,500 under the contract. His total collections for 1931 amounted to $11,874. During the three years 1929, 1930 and 1931 his total collections under the contract for the sale of the stock amounted to $64,999 (R. 5).

In March of 1932 the purchase price of the stock was reduced to $75,000. Therefore, the most that the respondent might ever hope to collect under the contract for the sale of the stock is $64,999, collected during the years 1929, 1930 and 1931, plus $75,000, representing the purchase price agreed to in 1932. This results in an aggregate amount of $139,999, which is the maximum amount that can be received by the respondent for the sale of the stock. Accord-

ingly, the profit reported by the respondent on his return for the year 1929, $194,000, was $54,000 in excess of the sum which he can finally hope to collect. (R. 5-8).

The Court of Claims found as a fact that the basis on which the respondent filed his return for the year 1929 did not clearly reflect the respondent's income. The Court stated in part as follows (R. 8):

> "Moreover, the basis on which plaintiff reported the transaction in his return for 1929 and the basis on which the Bureau held him taxable when the claim for refund was finally rejected in 1933 did not clearly reflect plaintiff's income. In March 1932, almost a year before the Commissioner rejected plaintiff's refund claim, the contract of sale of the stock in question was changed and the then unpaid purchase price thereof was reduced to $75,000. The maximum amount which plaintiff therefore could ever receive under the contract for sale of the stock was $139,999 instead of a net selling price of $240,000, which is $54,000 in excess of the sum stated as profit in the return for 1929."

II.

The Basis Adopted by the Respondent for Reporting the Transaction in His 1929 Income Tax Return Did Not Constitute a Binding Election Because the Method Used Did Not Truly and Correctly Reflect the Respondent's Income.

The wording of the law (Section 44, Revenue Act of 1928) which grants the taxpayer the privilege of reporting such a sale on the installment basis discloses no intent on the part of Congress to make a choice of one method or the other a binding election. The statute does not even use the word "election" in reference to installment sales of property. The statute merely states that the income from such a sale may be reported in the manner prescribed. Likewise, the Regulations (Regulations 74, Articles 352 and 353) do not even imply that a choice of one or the other

method in reporting the sale of property shall be construed as a binding election. There is nothing in the law or the regulations which makes respondent's original choice a binding election or which justifies the action of the Commissioner of Internal Revenue in refusing to allow respondent to make the change which he requested.

The United States Board of Tax Appeals has considered a number of cases where changes by taxpayers to or from the installment method of reporting income were involved. The rule adopted by the Board is that where the original method of reporting income does not truly or correctly reflect income the taxpayer is not bound to an election but may change to a method of reporting which does truly and correctly reflect the income from the transaction under consideration. *Key Largo Shores Properties, Inc.* v. *Commissioner*, 21 B. T. A. 1008, 1012; *Ives Dairy, Inc.* v. *Commissioner*, 23 B. T. A. 579, 584, affirmed 65 F. (2d) 135 (C. C. A. 5); *Boone, et al.* v. *Commissioner*, 27 B. T. A. 1064.

In *Key Largo Shores Properties, Inc.* v. *Commissioner of Internal Revenue*, *supra*, the Board of Tax Appeals held:

> "The fact that petitioner originally reported income from the sale of real estate on the installment basis does not preclude it from changing to the deferred payment basis where the installment basis does not correctly reflect income."

In the course of its opinion the Board declared as follows on page 1012 of 21 B. T. A.:

> "Under the Revenue Acts various methods of reporting income may be adopted by taxpayers, but all are designed to correctly reflect the true income in order that a just tax may be levied and collected. If a method used by a taxpayer does not clearly reflect income, the respondent may determine the income according to a method which in his opinion does clearly reflect it. Section 212, Revenue Act of 1926. This in itself is sufficient to demonstrate that it was not in-

tended that taxpayers should be irrevocably bound by the election of a method of reporting when that method is erroneous. The effect in this case of requiring adherence to the basis originally adopted by the taxpayer would be to set up and tax, as income, an amount which in fact is not income. Neither administrative rules nor the forceful arguments in favor of administrative expediency can create income where in fact there is none, and, after all, it is only income that is to be taxed. In our opinion the installment basis when applied to the facts in the present case does not reflect the taxpayer's income."

In *Boone et al.* v. *Commissioner*, 27 B. T. A. 1064, the Board held that where income was originally reported on the accrual basis the taxpayer could later change to the installment basis in order to clearly reflect income. At page 1067 of 27 B. T. A. the Board said:

"Respecting respondent's contention that because petitioners in their returns for 1920 reported the profit from the sale on an accrual basis they cannot now change to the installment basis, we again disagree. We have previously held that there was no statutory authority for reporting income on the installment basis under the Revenue Act of 1918, B. B. Todd, Inc., 1 B. T. A. 762; H. B. Graves Co., 1 B. T. A. 859; Hoover-Bond Co., 1 B. T. A. 929. Obviously, therefore, when petitioners filed their returns for 1920 they had no right to report the income from this sale on the installment basis. This privilege was accorded them by the provisions of section 212 (d) of the Revenue Act of 1926 as retroactively applied by section 1208 of the same act. To hold that petitioners can not change the method of reporting this installment sale would be contrary to the intention of Congress as expressed in these sections. Laurence H. Lucker, 21 B. T. A. 93; Potter Farms, Inc., 6 B. T. A. 111; Standard Computing Scale Co. v. United States, 52 Fed. (2d) 1018; M. L. Elken, 7 B. T. A. 1160; R. L. Brown Coal & Coke Co., 14 B. T. A. 609. Cf. Key Largo Shores Properties, Inc., 21 B. T. A. 1008."

The Commissioner relies on such cases as *Strauss* v. *Commissioner*, 33 B. T. A., 855, affirmed 87 Fed. (2d) 1018 (C. C. A. 2) *Rundel* v. *Commissioner*, 21 B. T. A. 1019; *Johnson Realty Trust* v. *Commissioner*, 21 B. T. A. 1333; *Ellis* v. *Commissioner*, 16 B. T. A. 1225; *Viault* v. *Commissioner*, 36 B. T. A. 430. However all of these cases involve the conclusion or finding that the basis first used by the taxpayer did correctly reflect income. In fact, the Board in *Key Largo Shores Properties, Inc.* v. *Commissioner*, *supra*, distinguished such cases at page 1011 of 21 B. T. A. as follows

> "The cited cases either presume or decide that the method first employed by the taxpayer served to reflect the true income and proceed on the theory that in such cases it is in the interest of administrative expediency to require adherence to the first method elected. * * *"

The United States Court of Appeals for the Fifth Circuit has reached the same conclusion. *Ives Dairy, Inc.* v. *Commissioner*, 65 Fed. (2d) 135. In fact, in the early case of *Morrow Becker & Ewing, Inc.* v. *Commissioner*, 57 Fed. (2d) 1, 2 (C. C. A. 5), the Court reversed the Board and stated in part, as follows:

> "* * * In this case the Commissioner put his refusal to allow the amended return on the ground that petitioner had chosen the installment basis for reporting profits and could not change. This gave no effect to changes in the law and regulations occurring afterwards. In view of the radical changes in the law, of which the petitioner had scant notice, if any, in fairness and justice to the taxpayer the returns should have been received and considered. Taxes are assessed on income and not on honest mistakes of the taxpayer. It was the duty of the Commissioner to do nothing arbitrary or unreasonable that would deprive petitioner of rights created by the new law and the regulations thereunder. It was a breach of discretion on the part of the Commissioner not to receive the amended return from 1925 under the circumstances disclosed."

The Court of Claims has consistently held that a taxpayer may change to the installment basis of reporting income where the original basis used did not truly reflect income. *Davis* v. *United States*, 71 Ct. Cls. 444, 46 Fed. (2d) 377, and opinion in the instant case.

Furthermore, the situation presented here is analogous to that presented under the capital net gain provision of Section 101 of the Revenue Act of 1928. That section provides:

> "In the case of any taxpayer other than a corporation who for any taxable year derives a capital net gain (as hereinafter defined in this section), there shall, *at the election of the taxpayer*, be levied, collected and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½% of the capital net gain." (Italics supplied.)

In other words, the taxpayer may pay a tax at the rate of 12½ per cent of his capital net gain or may report the capital net gain as ordinary income and pay the ordinary tax rate on it. It should be noted that this section specifically provides that the taxpayer shall *elect* the method which he desires to use. In spite of the use of the phrase "election of the taxpayer" in the statute, it has been consistently held by the Bureau of Internal Revenue and by the Board of Tax Appeals that a choice of one or the other method is not a binding election but may be changed after the return is filed, if it is advantageous to the taxpayer to do so. In G. C. M. 2367, Int. Rev. Cumulative Bulletin VI-2, page 172, in considering Section 206 (b) of the Revenue Act of 1921, which corresponds to Section 101 of the Revenue Act of 1928, the General Counsel of the Bureau of Internal Revenue stated in said Cumulative Bulletin:

"It was evidently the purpose of section 206 (b) of the Revenue Act of 1921 to allow taxpayers with respect to capital gains to compute the tax either under that section or under sections 210 and 211 whichever would produce the lesser tax. The parenthetical expression 'at the election of the taxpayer' as used in section 206 (b) carried out this purpose and does not imply a technical election which once made is binding on the taxpayer. No real election is involved; that is, no election between two desirable alternatives, since obviously all taxpayers will desire to avail themselves of section 206 if it results in a lesser tax. In such a case, if that section is not availed of, it must be through ignorance or mistake."

In that memorandum the General Counsel ruled that a taxpayer who had filed his original return reporting his capital net gain as ordinary income should be allowed to amend his return and be taxed at the rate of 12½ per cent on his capital net gain. In G. C. M. 13466, published in September, 1934, in Internal Revenue Bulletin, Vol. XIII-1, page 144, the above rule was held to apply where at the time the original return was filed it was to the advantage of the taxpayer to return his capital net gain as ordinary income, but upon an audit of his return and an increase of his ordinary income, it became advantageous to the taxpayer to change his method of reporting said income and be taxed on his capital net gain at 12½ per cent.

The above quoted portion of G. C. M. 2367 was approved and the rule reiterated as follows:

"The conclusions reached in the foregoing rulings were based upon the theory that where a taxpayer has the right to be taxed at one of two rates he will always choose the lower rate, and that the 'election' to have capital gains so taxed really means the right to have such income taxed at the capital gain rate if it is more advantageous to the taxpayer. If the taxpayer does not elect to be taxed at the lower rate it will doubtless be due to ignorance or mistake and he should have the right to elect with full knowledge of all the facts and

the consequences of an election. The possibility of a taxpayer electing to be taxed at the higher rate is too remote for contemplation."

See also I. T. 2132, IV-1, C. B. 117, *James F. Hoey* v. *Comm.*, 4 B. T. A. 1043; *Fifth Third Union Trust Co.* v. *Comm.*, 20 B. T. A. 88.

The reasons advanced by the General Counsel in the above quotations in support of his ruling, that a choice of one of the two methods of reporting capital net gain does not constitute an election, apply with equal force to Section 44 of the Revenue Act of 1928 and support respondent's contention in regard to that section of the law. It is equally true that in the case of an installment sale of property all taxpayers would desire to avail themselves of the method which would result in the lesser tax and a failure to do so "must be through ignorance or mistake" and therefore there is no election between two desirable alternatives. There is no sound reason why a choice under Section 44 of the Revenue Act of 1928 should constitute a binding election when a choice under Section 101 of the same Act does not constitute a binding election, especially since Section 101 specifically provides that the method used shall be "at the election of the taxpayer." It is submitted that Congress did not intend that a choice by a taxpayer of one of the two methods allowed for the reporting of income from an installment sale of property should constitute a binding election, and that the Commissioner erred in so ruling and in refusing to allow respondent to correct the error made in the original return.

The instant case is distinguishable from the line of cases involving taxpayers on the accrual basis. If this taxpayer had been on the accrual basis of accounting and had reported the profit on the accrual basis as income for 1929, his return might have been correct for it would have reflected the profit for 1929 on the accrual basis of accounting. Accordingly he would not have had any error to correct by filing a claim for refund.

However, this taxpayer is on the cash basis of accounting. On that basis he did not derive a profit of $194,000 from the sale in 1929. On a cash basis his income for the year 1929 is distorted by reporting a profit of $194,000. On the accrual basis of accounting such a profit would perhaps have been correct. Therefore, inasmuch as the respondent reported for the year 1929 on a cash basis and reflected an erroneous and unreasonable profit from the sale, he is entitled to correct this error by means of a claim for refund. *Davis* v. *United States, supra.*

In *Bruce McDonald et al.* v. *Commissioner,* 52 Fed. (2d) 920, the United States Circuit Court of Appeals for the Fourth Circuit held that in the case of a casual sale of personal property the taxpayer was entitled to adopt the installment method of reporting the income from the transaction under consideration although the question was raised for the first time in the taxpayer's brief on appeal to the Circuit Court of Appeals. The Court pointed out in the concluding paragraph of its opinion that since the case had to be sent back to the Board of Tax Appeals for the correction of certain errors the petitioner might request the Board in further proceedings to apply the installment provisions of the statute.

III.

Cases Relied on by the Commissioner Distinguished.

The Commissioner relies on such cases as *Alameda Investment Company* v. *McLaughlin,* 33 Fed. (2d) 120 (C. C. A. 9); *Radiant Glass Company* v. *Burnet,* 54 Fed. (2d) 718 (App. D. C.), *Safety Electric Products Co. Inc.* v. *Helvering,* 70 F. (2d) 439 (C. C. A. 9); *Dr. Pepper Bottling Co.* v. *Commissioner,* 69 Fed. (2d) 768 (C. C. A. 5); *Lucas* v. *St. Louis National Baseball Club,* 42 F. (2d) 984 (C. C. A. 8).

These cases involve efforts by affiliated corporations after the time for the filing of returns to change either to or from separate or consolidated corporation income tax returns.

The Commissioner also relies on such cases as *Rose* v. *Grant,* 39 Fed. (2d) 340 (C. C. A. 5); *Buttolph* v. *Commissioner,* 29 Fed. (2nd) 695 (C. C. A. 7); *United States* v. *Pettigrew,* 81 Fed. (2d) 666, (C. C. A. 9) and *Morris* v. *Commissioner,* 40 Fed. (2d) 504 (C. C. A. 2). This line of cases involve efforts of married persons to make elated changes to or from separate or joint individual income tax returns. Such situations as were considered in the above cases involve real elections under the pertinent sections of the statute and regulations and there was no question but that the original returns filed clearly reflected the income. As pointed out hereinabove neither section 44 of the Revenue Act of 1928 nor the regulations of the Commissioner thereunder so much as imply that a choice of computing the profit on installment sales constitutes a binding election.

IV.

The Question Here Involved is Largely One of Fact and We Believe That the Findings of Fact of the Court of Claims Should Not, Under the Decisions of This Court, be Disturbed Upon Appeal.

In his specification of errors to be urged (p. 5 Petition for Writ of Certiorari) the Commissioner submits that the Court of Claims erred as follows:

> "In holding that the method or basis adopted by the taxpayer for reporting his taxable income for the year involved did not clearly reflect his income."

The Court of Claims found as a fact (R. 5) that for 1929 and all subsequent years the taxpayer kept his books of account and made his Federal income tax return on the cash receipts and disbursements basis. The Court of Claims further found (R. 8) that the basis on which the taxpayer reported the transactions here involved in his 1929 return did not clearly reflect the taxpayer's income. There is no showing by the Commissioner in this case that the findings

of fact of the Court of Claims were not supported by substantial evidence. The Transcript of Record, upon which the findings of the Court were based, has not been sent up to this Court with the exhibits as part of the record in this cause. It is therefore respectfully submitted that the Commissioner has failed to substantiate his contention that the Court of Claims erred in its findings of fact. *Helvering* v. *Rankin*, 295 U. S. 123; *General Utilities & Operating Company* v. *Helvering*, 296 U. S. 200; *Elmhurst Cemetery Company* v. *Commissioner*, 300 U. S. 37.

It is further submitted that the Commissioner cannot successfully urge that a finding of fact contained in the opinion of the Court below should not be considered as a finding of fact upon appeal. *Bradley W. Palmer* v. *Commissioner*, 302 U. S. 63.

In his brief in opposition to petition for Writ of Certiorari in *Pacific National Company* v. *Welch*, No. 528, the Commissioner stated the following, at page 12:

> "* * * In Kaplan v. United States, 18 F. Supp. 965, the Court of Claims held, though upon insufficient findings of fact, that the taxpayer, who was upon a cash receipts basis, had erroneously and mistakenly reported in his return for the taxable year the entire profit which it appeared at the time might ultimately be received but which was not actually received, and that the basis on which he reported the transaction did not clearly reflect his income. While we do not believe that that decision is correct we think it is distinguishable from the present case when read in the light of the opinion of the Court of Claims in LeBolt & Co. v. United States, 67 C. Cls. 422 * * *"

This would indicate that the Commissioner believes that the questions involved in the instant case are largely ones of fact and that the case is distinguishable from the *Pacific National Company* v. *Welch*, No. 528, because of the findings of fact by the Court of Claims showing that the taxpayer in filing his return for the year 1929 did not clearly reflect the

income from the casual sale of personal property here involved.

CONCLUSION.

It is respectfully submitted that the decision of the Court of Claims was correct and should be affirmed.

Respectfully submitted,

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APPENDIX.

Revenue Act of 1928, c. 852, 45 Stat. 791:

PART II—COMPUTATION OF NET INCOME

SEC. 21. NET INCOME.

"Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

SEC. 22. GROSS INCOME.

(a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

* * * * * * * * *

(e) *Determination of gain or loss.*—In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in sections 111, 112, and 113.

PART IV—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section

48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year. (For use of inventories, see section 22 (c).)

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period.

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits provided for in this title shall be taken for the taxable year in which "paid or accrued" or "paid or incurred", dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period.

SEC. 44. INSTALLMENT BASIS.

(a) *Dealers in personal property.*—Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price.

(b) *Sales of realty and casual sales of personalty.*—In the case (1) of a casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year), for a price exceeding $1,000, or (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed 40 per centum of the

selling price, the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this section. As used in this section the term "initial payments" means the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made.

(c) *Change from accrual to installment basis.*—If a taxpayer entitled to the benefits of subsection (a) elects for any taxable year to report his net income on the installment basis, then in computing his income for the year of change or any subsequent year, amounts actually received during any such year on account of sales or other dispositions of property made in any prior year shall not be excluded.

SUPPLEMENT B—COMPUTATION OF NET INCOME

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

(a) *Computation of gain or loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.

* * * * * * * * *

(c) *Amount realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(d) *Recognition of gain or loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 112.

(e) *Installment sales.*—Nothing in this section shall be construed to prevent (in the case of property sold under contract providing for payment in installments) the taxation of that portion of any installment pay-

ment representing gain or profit in the year in which such payment is received.

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss determined under section 111, shall be recognized, except as hereinafter provided in this section.

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * * * * * *

Treasury Regulations 74:

ART. 321. *Computation of net income.*—Net income must be computed with respect to a fixed period. Usually that period is 12 months and is known as the taxable year. Items of income and of expenditures which as gross income and deductions are elements in the computation of net income need not be in the form of cash It is sufficient that such items, if otherwise properly included in the computation, can be valued in terms of money. The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. (See articles 331-333.) If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation shall be made in such manner as in the opinion of the Commissioner clearly reflects it.

ART. 322. *Bases of computation.*—Approved standard methods of accounting will ordinarily be regarded as

clearly reflecting income A method of accounting will not, however be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency. * * *

ART. 331. *When included in gross income.*—Gains, profits, and income are to be included in the gross income for the taxable year in which they are received by the taxpayer, unless they are included as of a different period in accordance with the approved method of accounting followed by him. * * *

ART. 351. *Sale of personal property on installment plan.*—

* * * * * * * * *

In the case of a casual sale or other casual disposition of personal property other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, for a price exceeding $1,000, income may be returned on the installment basis provided the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale or other disposition is made do not exceed 40 per cent of the selling price.

If for any reason the purchaser defaults in any of his payments, and the vendor returning income on the installment basis repossesses the property, the entire amount received in installment payments and retained by the vendor, less the sum of the profits previously returned as income and an amount representing proper allowance for damage and use, if any, will be income of the vendor for the year in which the property is repossessed, and the property repossessed must be carried on the books of the vendor at its original cost, less proper allowance for damage and use, if any.

If the vendor chooses as a matter of consistent practice to return the income from installment sales on the straight accrual or cash receipts and disbursements basis, such a course is permissible.

If an installment obligation is satisfied, or otherwise disposed of, gain or loss may result therefrom and must be determined in accordance with section 44 (d) and article 355.

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SUPREME COURT OF THE UNITED STATES.

No. 667.—October Term, 1937.

United States of America, Petitioner, vs. Harry A. Kaplan. } On Writ of Certiorari to the Court of Claims.

[May 2, 1938.]

Mr. Justice Butler delivered the opinion of the Court.

Respondent and his wife in a joint return of income tax for 1929 reported a profit of $194,000 from the sale of 25 shares of the stock of "No. 1100 Park Avenue," and disclosed tax of $2,084.20 which was paid. The taxable income was less than the profit in question. It resulted from the sale by him, April 11, 1929, for a net price of $240,000 of stock bought in 1928 for $46,000. The buyer agreed to pay $25,000 cash and the balance in installments of $1,875 a month. For 1930, respondent and his wife filed a return showing no taxable income. For 1931 and 1932, respondent filed no returns. In 1932 he filed a claim for refund of the entire 1929 income tax. The ground for the claim was that he was entitled to report the sale on the installment basis. The findings indicate that the deferred payments were worth less than face value; after respondent and his wife (to whom he assigned the contract) had received $55,000, they agreed to accept $75,000 more as full payment. The commissioner rejected the claim and this suit followed. The Court of Claims gave respondent judgment. 18 F. Supp. 965. This Court granted a writ of certiorari because of conflict between the decision and that of the circuit court of appeals for the ninth circuit in *Pacific National Company* v. *Welch*, 91 F. (2d) 590, this day affirmed. The question here presented is the same as the one decided in that case. The judgment of the court below must be reversed.

It is so ordered.

Mr. Justice Cardozo and Mr. Justice Reed took no part in the consideration or decision of this case.